SOLVENCY OF THE VETERANS' ADMINISTRATION HOME LOAN PROGRAM

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BEFORE THE

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HOUSING AND MEMORIAL AFFAIRS

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HOUSE OF REPRESENTATIVES

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SOLVENCY OF THE VETERANS' ADMINISTRATION HOME LOAN PROGRAM

THURSDAY, JUNE 16, 1988

U.S. House of Representatives,
Subcommittee on Housing and Memorial Affairs,
Committee on Veterans' Affairs,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10 a.m., in room 334, Cannon House Office Building, Hon. Marcy Kaptur (chairwoman of the subcommittee) presiding.

Present: Representatives Kaptur, Patterson, and Rowland of Georgia.

OPENING STATEMENT OF CHAIRWOMAN KAPTUR

Miss **Kaptur**. The subcommittee will be in order.

The hearing this morning is going to focus on the solvency of the Veterans' Administration Home Loan Guaranty Program, and I truly want to thank all of the witnesses who are going to spend time with us today. It is going to be a long hearing. We hope to stay within the 5-minute rule.

As you know, last year the Veterans' Administration guaranteed the 12 millionth home loan in our country, which is a real tribute to the program's success. However, as all of the witnesses know, the Home Loan Guaranty Fund is severely depleted, and during the past 5 fiscal years the revolving fund has received over $1.7 billion in external financing, nearly $1 billion in this fiscal year alone, so the challenge before us is to try to find a way in which to preserve this program as an entitlement for veterans while ensuring its solvency in the long term.

Therefore, our purpose this morning is to discuss revenue enhancement initiatives which will ensure that this program can continue to be a veterans' benefit. I want to reiterate that this program was not necessarily intended to be totally solvent in the business sense, since it is an entitlement program. However, this should not preclude the program from operating in a fiscally prudent manner. We know that because of economic conditions around the country and so forth, there has been special stress put on the program. That, plus higher interest rates in the late 1970's, accounted for the condition of the fund at the present time.

All of the witnesses have been presented with two alternatives to funding the program. These are not exclusive, however. We know that some of the witnesses have other ideas as to how we might create a program that would be self-sufficient in the long term, but we did choose to focus on these first two, since they were the most developed.

Now the first proposal includes the collection of an indemnity fee of 1.25 percent from veterans, accompanied by a similar government contribution to a special account. The veteran would in turn be released from liability from the Veterans' Administration, should he or she default on that loan. The VA would be mandated to invest any excess funds in this special trust fund.

In essence, we would be creating a new home loan program whereby revenue generated would be used to offset future losses, rather than pay claims on loans previously closed. This approach allows for a buildup of reserves which should improve the long-term solvency of the program. The Congressional Budget Office, in its reports to this committee, has indicated that this approach could create a reserve of over $1 billion over a 10-year period of time.

Now there was another proposal presented at the March 17th hearing by Professor Robert Edelstein. He suggested to the committee a shared equity program as a way of making the VA home loan program solvent over the long term. The Congressional Budget Office was unable to cost this particular proposal, but it is my understanding that Professor Edelstein will be addressing this issue in his testimony.

Witnesses were also asked to submit your own ideas for the salvation of the program, and I saw one for a new revenue bond program. I will be interested to hear more about that.

Again, I wish to reiterate my firm commitment and this committee's to the continuation of this program as a viable benefit program. I am firmly committed that this program is salvageable and worthy of every bit of our effort. Therefore, I am most anxious to hear all the thoughts here this morning on what direction the program should take.

[The prepared statement of Chairwoman Kaptur appears on p. 57.]

Miss KAPTUR. I wanted to leave the record open. I know that Mr. Burton, the ranking member, has a statement to make. How did you wish to handle that, Kingston?

Mr. SMITH. Madam Chairwoman, Mr. Burton is delayed and expects to be here very shortly. He asks unanimous consent to be permitted to make his statement when he arrives.

Miss KAPTUR. All right. Without objection, we will do that when he arrives.

[The prepared statement of Hon. Dan Burton appears on p. 60.]

Miss KAPTUR. I would like to now call up the first panel of witnesses, if I could: Mr. Robert Vogel, chief benefits director, Veterans' Administration, accompanied by Mr. Keith Pedigo, director of the Loan Guaranty Service, and Mr. James Kane, assistant general counsel, and Mr. Marvin Markus, managing director of Kidder, Peabody, and Company; Mr. Jonathan Plutzik, managing director of The First Boston Corporation; and Mr. Mark Buchman, president of Ginnie Mae, the Government National Mortgage Association.

We welcome all of you gentlemen here this morning. Mr. Vogel, I have had a chance to look at your testimony ahead of time and look forward to your delivering it here this morning. Welcome.

STATEMENT OF ROBERT J. VOGEL, CHIEF BENEFITS DIRECTOR, VETERANS' ADMINISTRATION, ACCOMPANIED BY R. KEITH PEDIGO, DIRECTOR, LOAN GUARANTY SERVICE; JAMES P. KANE, ASSISTANT GENERAL COUNSEL; MARVIN MARKUS, MANAGING DIRECTOR, KIDDER, PEABODY, AND COMPANY, INC.

Mr. **Vogel**. Thank you very much, Madam Chairwoman. I have a brief summary statement, and ask that the full statement be placed in the record.

Miss **Kaptur**. It will be done so.

Mr. **Vogel**. It is a pleasure to appear before you again to discuss the operation of the VA's housing program.

The first item I would like to discuss is the draft bill entitled "Veterans' Home Loan Mortgage Indemnity Act of 1988." This would establish a new fund known as the Veterans' Administration Mortgage Indemnity Fund—MIF. The MIF would pay for all housing loan operations with respect to loans originally guaranteed after the effective date of the bill. The existing fund would cover expenses related to loans made prior to the effective date.

The bill would also increase the fee collected from veterans obtaining guaranteed loans from the present 1 percent to 1.25 percent. The fee for vendee loans would remain at 1 percent, and for those assuming existing loans it would remain at one-half of 1 percent. In addition, there would be credited to the MIF an amount equal to a quarter of 1 percent of the original loan amount of each loan guaranteed after the effective date of the bill for 3 fiscal years.

The draft would provide that veterans obtaining guaranteed loans after the bill's effective date would not have any liability to the Government. The VA is aware that in recent years the cost to the taxpayers of operating this important benefit to veterans has been significant. We believe the draft bill should be analyzed further, and have identified some of the issues we believe require further study.

Some of the potential issues we would like to investigate further include the concept of no future liability to veterans who pay the new fee and the ability of the existing revolving fund to pay the costs associated with loans already guaranteed. The liability provisions of the current program provide a strong incentive for veterans to maintain their loan obligations and to cooperate with loan holders and the VA in exploring alternatives to foreclosure. Many veterans who have become delinquent make a considerable effort to work out the default. Adoption of the proposal would remove that incentive.

Under the draft legislation, the Government would be required to contribute a quarter of 1 percent of the dollar amount of each loan for 3 years. Creation of a new permanent budget authority of this type may run counter to the Budget Impoundment Control Act of 1974.

We also don't believe that service-connected disabled veterans should be required to pay the fee. At present they are not required to pay the 1 percent funding fee.

Our concern as to the solvency of the loan guaranty program led us to contract with Peat, Marwick, Main & Co. to conduct a study of various mortgage insurance options. Topics include the design of a mortgage insurance program which maintains its status as a veterans' benefit. We expect the study will be done around the end of this fiscal year. We would like to consider your proposal further in conjunction with that study.

The second draft bill would authorize the VA to sell loans with or without recourse, if the amount received on such a sale is equal to no less than 90 percent of the unpaid balance. For all intents and purposes, this would preclude the sale of loans without recourse. Instead, we believe the law should be amended to grant the VA flexibility to sell loans in a cost-effective manner, either with or without recourse.

Section 2 of the draft bill revises the computation of available entitlement after prior use of the loan guaranty benefit. As drafted, this section would eliminate the requirement for the restoration of entitlement, that property securing a VA loan be disposed of by the veteran. In the past we have opposed such change, since our main goal is to assist veterans in obtaining their primary home.

From informal discussions with your staff, we understand this amendment is intended to assist veterans in obtaining interest rate reduction refinancing loans. We have no objection to that provision, if it were limited to interest rate reduction refinancing cases.

Section 3 would change the standards for considering waiver of a debt established against the veteran as the result of foreclosure on a VA-guaranteed loan. It is our impression that the purpose of this section is to liberalize the criteria for waiver of indebtedness, and our preliminary reading of that section does not convince us that, as drafted, it will accomplish what seems to be intended.

Section 4 provides the sense of the Congress as to the use of auctions in selling VA-acquired properties. The recently enacted supplemental appropriation for the Loan Guaranty Revolving Fund permitted us to reexamine our auction schedule. We reduced the number of auctions and have resumed using our former auction criteria to authorize auctions. They will only be used in those locations where we have a significant number of older, hard-to-sell properties.

The sale of properties through individually brokered sales will remain our principal method of selling properties. Ninety-five percent of more than 34,000 properties sold last year were through sales brokers. The auction method is used by all other major participants in the foreclosed property sales market. In view of this, we don't think it is prudent to have the VA alone refrain from using that viable sales alternative.

I would like to offer the following comments on the recommendations to lease properties with incentives such as an option to purchase. The most significant barrier to more widespread use of leases is that they don't provide the cash flow that the revolving fund needs, as do sales. In addition, when we lease a property it becomes subject to local landlord-tenant laws that may require the

VA to expend significant amounts in repairs to bring it up to code, giving us an immediate negative cash flow with little hope of ever recovering those additional costs.

The last item provided for our comments was the proposal by Professor Edelstein for a "shared equity" program. We would like to take more time to perform an in-depth appraisal of that proposal. However, our initial reaction to the program would lead us to oppose its implementation.

Professor Edelstein's proposal is that veterans give the VA a portion of their profit or equity when they sell the home. There would be great difficulty in administering such a program. We would have to audit sales and have a detailed method of determining the true equity or profit, taking into account monies spent by the veterans to improve their property, tax laws, profit based strictly on inflation, et cetera. Since it would be very difficult to predict when veterans would sell their homes and the amount of profit veterans would make, we would have difficulty projecting the revenues that would be available from the proposal.

In addition, it raises questions as to the fairness for veterans participating in the program. To in effect impose a tax on a veteran's profit derived from the sale of a home in addition to the tax imposed by the Internal Revenue Service, would unfairly penalize the vast majority of responsible veteran borrowers. Many stronger borrowers would likely decide to use FHA or conventional financing, rather than surrendering a portion of their equity to the Government, thus leaving the most likely to default as the principal users of the VA benefit. That could lead to an even greater percentage of defaults and higher costs in the long run.

Madam Chairwoman, that concludes my statement. I would be pleased to answer any questions you or members of the subcommittee may have.

[The prepared statement of Mr. Vogel appears on p. 61.]

Miss KAPTUR. Thank you, Mr. Vogel.

Mr. Pedigo doesn't have anything to add at this point, does he?

Mr. PEDIGO. No, ma'am.

Miss KAPTUR. All right. If it would be all right with you, we will continue with the other witnesses and hold the questions until this panel is complete. I understand Kidder, Peabody, and Company also is just accompanying the Veterans' Administration and does not have formal testimony.

Mr. MARKUS. That is correct.

Miss KAPTUR. All right. Then I would like to turn to Mr. Jonathan Plutzik from The First Boston Corporation, please. Glad to have you back.

STATEMENT OF JONATHAN PLUTZIK, MANAGING DIRECTOR, THE FIRST BOSTON CORPORATION

Mr. PLUTZIK. Thank you very much. Let me begin by saying that First Boston is a full-service international investment bank headquartered in New York. By way of background, for purposes of today's hearing, let me point out that First Boston currently serves as co-lead manager in the upcoming sale of securities from the agency's vendee portfolio.

Based on this experience, the work we have done in connection with this sale, combined with our overall capital markets perspective, we have focused our testimony today on just one of the proposals that you are discussing, namely the proposal to require that nonrecourse vendee loan sales be permitted only if the amount received is equal to an amount which is not less than 90 percent of the unpaid balance of the loan. In our judgment, that 90 percent requirement would effectively preclude nonrecourse sales of loans from the vendee portfolio, because quite frankly the stand-alone investment value of existing portfolio vendee loans is viewed by the capital markets as being well below the 90 percent of their unpaid balances.

Let me digress for just a moment and say that these loans have an intrinsic value, as judged by the marketplace, well below that 90 percent. That value is determined as a combination of the interest rate on the loan, the maturity of the loan, and the perceived credit-worthiness of that loan.

These are all things that are combined in determining the investment community's judgment about what those loans are worth. I would be pleased to talk about that more in the question period if you would like. These characteristics which I mentioned prompt investors to demand a discount in order to purchase these loans. I should stress that this phenomenon is not unique to the vendee loan portfolio. Rather, it is a basic reality of the marketplace.

I want to emphasize as I make these comments to the subcommittee, however, that the existence of these discounts does not mean that the Government receives less than fair value for the assets sold. Rather, the discounts represent the judgment of the marketplace—that is, the considered judgment of a large number of investors, people who ultimately put their money up to buy these securities—as to the value of those securities relative to other investment opportunities in the current interest rate environment.

It is our belief that any legislative attempt to fix the 90 percent minimum level of receipts for VA's nonrecourse sales would be based upon, we believe, factually insupportable assumptions of the value of that portfolio in the Government's hands. We find no basis from the capital market's perspective for assuming that a vendee loan on the Government's books, with a dollar's worth of unpaid balance, is actually worth a dollar to the Government if it is sold on a nonrecourse basis to the public. Indeed, evidence suggests, based on experience with the pilot program, that the market believes that, what I will describe as policy-oriented Government loans in general, may be worth less than their unpaid balances, depending on the coupon, maturity, and credit-worthiness of those loans themselves.

It is important to stress here again that the same would be true for private securities sold to the capital markets, that is, loans held by private-sector institutions, securitized and sold into the marketplace. We believe that nonrecourse asset sales represent a fair measure of the economic value of the Government's loan portfolio.

I would like to point out that we believe that VA is in a unique position, insofar as it has sold many loans on a recourse basis, and it is now in a position or will be in a position to compare the relative value of benefits associated with both nonrecourse and recourse sales. We believe that those benefits are both qualitative and quantitative. We believe, further, that there are many benefits associated with nonrecourse sales, and I would be pleased to talk about those in detail as we get into the question period.

In closing, let me just say that it is our conclusion and our recommendation that nonrecourse loan sales are a valid and constructive management tool for the VA and produce fair value for the Federal Government. Further, a requirement that sales proceeds be at least equivalent to 90 percent of the unpaid balance would preclude further loan sales from the VA's vendee portfolio, and in doing so would deprive VA of real programmatic and management benefits that are otherwise attainable. We believe the Congress should retain VA's option to conduct nonrecourse sales without such a requirement that proceeds meet a preordained minimum level.

Thank you very much, Miss Kaptur.

[The prepared statement of Mr. Plutzik appears on p. 75.]

Miss **Kaptur**. Thank you, Mr. Plutzik. We will have some questions in a second.

I would like to now turn to the new president of the Government National Mortgage Association, Mr. Mark Buchman. We really welcome you this morning, and certainly appreciate Ginnie Mae's participation in this very important program. Glad to have you.

STATEMENT OF MARK E. BUCHMAN, PRESIDENT, GOVERNMENT NATIONAL MORTGAGE ASSOCIATION

Mr. **Buchman**. Thank you, Madam Chairman, Mrs. Patterson. It is a pleasure to be here. I will try to go through my testimony quickly and let the written piece stand for the record.

We do appreciate the invitation to present our views. VA paper accounts for about one-third of our total portfolio.

Miss **Kaptur**. One-third of your loan volume?

Mr. **Buchman**. Yes.

Miss **Kaptur**. Would you pull the microphone a little closer to yourself, please, Mr. Buchman?

Mr. **Buchman**. Sure. How's that?

Miss **Kaptur**. Fine.

Mr. **Buchman**. As you know, Ginnie Mae is a wholly-owned Government corporation, part of HUD. It provides a method for bringing secondary market capital into the mortgage market. We guarantee the timely payment of principal and interest on privately issued securities backed by FHA-insured or VA-guaranteed home mortgages.

Over 95 percent of all FHA and VA home loans are securitized through Ginnie Mae and, as I said, VA loans comprise about one-third of our business. Since the inception of the MBS program, we have issued approximately $480 billion in securities, of which about $325 billion are outstanding today, making us the most widely held and traded MBS securities in the world.

I mention this to make this point: that this tremendous growth in our securities outstanding brings with it additional responsibility and potential liability for the U.S. Government. Ginnie Maes bear the full faith and credit of the United States Government—

the only mortgage-backed securities that bear that guaranty. Thus, if an issuer defaults on his obligation to pass through to the investor the correct amount of principal and interest due on the home loans each month, Ginnie Mae steps in and makes the payments itself, thus ensuring that the investors receive their payment.

It is obviously in Ginnie Mae's and the Government's interest if lenders remain solvent and homeowners remain current in their loan obligations. Thus, we are alarmed at the steadily escalating delinquencies, defaults and foreclosures being experienced by both the FHA and the VA programs.

Although Ginnie Mae is usually able to receive complete indemnification from FHA if a loan goes bad, because of the protection added by FHA's self-supporting mortgage insurance premiums, Ginnie Mae has less protection from the VA program. This is partially due to the VA's much lower partial guaranty formula. The problem is aggravated when property values have fallen and by the law's "no-bid" procedure, which allows the VA to remit its loan guaranty to the lender and require the lender to dispose of the property, rather than selling the property itself.

In effect, Ginnie Mae already shares some of the financial risk of the loan guaranty program with guaranteed lenders. Thus, as a general principal, we cannot endorse any change in the VA program which imposes additional risks on the lender, diminishes the responsibility of the borrower, or weakens the guaranty fund from the VA's point of view.

You asked for our comments on the draft legislation and Professor Edelstein's proposal. Ginnie Mae really is not in a position to state exactly what the fee amount should be. We note that VA has contracted with a major accounting firm to do a study of the various mortgage insurance options. We welcome that. We think that is the correct way to determine what the fee should be. We urge the subcommittee to examine this report carefully before finalizing the amount of the fee.

We question the advisability of allowing the veteran to finance the funding fee. Many studies have shown that the greater the amount of cash a borrower has committed, the more incentives he or she will have to maintain the loan and the less likely the default.

We also object to the veteran's being released from liability, should he or she default. This is a sharp and unwarranted from current VA practice, and contrary to FHA and conventional loan liability as well. It is important that veterans share in the risk as well as the gain potentially afforded by homeownership under this program. This requires that veterans remain liable for debts due to foreclosure. It is also grossly unfair to the vast majority of veterans who maintain their loan obligations or cooperate with the VA and loan holders in exploring alternatives to foreclosure.

VA loan sales: We echo the VA's objections to language in Section 1 of the other draft bill which would place additional restrictions on the VA's ability to sell loans without recourse.

Computation of available entitlement: Like the VA, we do not object to Section 2 of the bill, which revises the computation of available entitlement after prior use of the loan guaranty benefit, as long as it is limited to interest rate reduction refinancing cases.

We ourselves have initiated a program to reduce the interest rates of borrowers who reside in mobile homes acquired by us, many of them through default of 12 mobile home lenders in the last 3 years.

Use of auctions: We also concur with the VA in cautioning against Section 4 of the proposed legislation. This section recommends that VA refrain from disposing of acquired properties through auctions. From Ginnie Mae's own perspective, we have contracted with an auction company to help us dispose of mobile homes which have not been sold through other aggressive marketing techniques.

The Edelstein shared equity proposal: We find the idea intriguing. We share, however, the VA's judgment that effective implementation would be an administrative nightmare, requiring exhaustive auditing and possible use of veterans' tax returns to ensure accurate determination of profit. Annual budget gains would be impossible to predict, with home sales and appreciation amounts, if any, incapable of reasonable estimation.

The VA also raises the specter that more financially secure borrowers, and those living in more prosperous areas, may well avoid the possibility of surrendering a portion of their equity and use FHA or conventional financing instead. This in turn could harm the solvency of the VA fund by leaving it to those most likely to default.

In view of time, I will skip the rest of this prepared testimony. I would comment, however, that we—as is stated in the written testimony—have a significant mobile home problem which has been brought to the attention of Congress before in our Appropriations Committees. A good number of these are VA mobile home program loans. Our losses have skyrocketed, and we are taking aggressive steps to minimize those losses.

Thank you very much, Madam Chairman.

[The prepared statement of Mr. Buchman appears on p. 82.]

Miss Kaptur. Thank you very much. In the bill that we passed last year, we required down payments for mobile homes. We are hoping that that will, in the VA program, limit some of your exposure down the road, but we recognized that problem and attempted a solution last year, so we will be real interested to see what the numbers show in the out years.

We appreciate your testimony very much, and your being with us this morning. I wanted to start with Mr. Vogel and just ask, particularly with regard to the lukewarm posture of your testimony, was your testimony substantially different prior to it being submitted to OMB for presentation to this committee?

Mr. Vogel. No, it wasn't, Madam Chairwoman.

Miss Kaptur. It was not, so it is basically the same as when it was drafted.

Mr. Vogel. I think most of the changes made were semantic rather than substantive.

Miss Kaptur. All right. Now you have stated in your testimony that you would be pleased to work with the committee regarding a solution to the solvency of the program, as well as some of the other proposals. This is really welcome news to us, and I am just curious as to what period of time you would be willing to work with the committee. What kind of a time frame would you have in mind on that?

Mr. **Vogel**. Well, we would expect by late fall or so to have some preliminary results, at least, from Peat, Marwick with regard to an insurance program and what might be necessary to put such a program into effect. Our offer to work with the committee is really timeless. I don't put a beginning or an end on that.

I don't know if Mr. Pedigo would like to add anything to that or not.

Mr. **Pedigo**. Madam Chairwoman, we always stand ready to work with the committee, especially on an issue so vital to our program. As Mr. Vogel said, we will have the result of the Peat, Marwick study sometime in the fall, possibly as early as late August, and we plan to ask Peat, Marwick to also analyze the proposal that you have made for the Mortgage Indemnity Fund, and we hope that in August or sometime in September we can present you with the results of that study. We are willing to work with your staff at any time.

Miss **Kaptur**. Tell me this: As far as your own thinking has progressed, you obviously have noted that the committee looks at the future as a significant departure from the present. In other words, we have to take care of the problems in the existing program but we are looking at a way of creating a new program that would be financially solvent. Does your own thinking go along that path, or are you trying to somehow fix the old program?

Mr. **Vogel**. I really don't think that the current difficulty that we are in is certainly getting all the management attention we think it needs, and it is considerable. We don't believe that we can continue the program the way it is with a "business as usual" posture. We are looking for the best way to work out our current funding problems.

The amount of claims experienced, the amount of claims being paid, continues to run high. I just saw the other day the May figures, and they were a little higher than we had anticipated, but we believe it is a valuable benefit program, and I know that is a view shared by you, Madam Chairwoman. We would like to retain that feature and be able to, very frankly, get away from or avoid, to the extent it is possible, at least the size of the appropriations that are needed at present.

Miss **Kaptur**. Let me say, I share your discomfort with that position, so we are very serious about moving expeditiously in this committee to try to stem the tide from the old program and find a way to create a very solid foundation for the future of this extremely important program.

One of the questions I wanted to ask you or Mr. Pedigo, I don't quite understand the VA's fear that the proposal, our major proposal, the indemnity proposal, would result in a loss of incentive on the part of the veteran to pay the mortgage, because if that individual is faced with the loss of the home and all of the investment that has been put into that home, isn't that a sufficient incentive to pay? I would appreciate your comments on that.

Mr. **Pedigo**. Certainly that is a significant incentive, but we have found that that is not enough of an incentive for many borrowers, whether they be veterans or nonveterans. It seems that today there is no longer the stigma to losing a home that there once was, and our experience tells us that we need to hold a pretty strong hammer, if you will, over the heads of the borrowers to try to provide them with additional incentive to continue making those payments when they encounter financial difficulty. We feel that our longstanding policy of holding the veteran liable for any debt that the Government has to pay as a result of giving the loan to the veteran, is a viable means to reduce our outlays.

Miss KAPTUR. You have stated in your testimony that you are concerned about our major proposal, for a number of reasons. We have received an estimate from the Congressional Budget Office that the indemnity program would net a reserve of over $1 billion over a 10-year time frame, and in fact after 3 years the existing Loan Guaranty Revolving Fund would need no additional appropriations. We think that is pretty solid evidence that we should continue pursuing this proposal. Do you have any suggestions at the current time that would produce comparable results?

Mr. PEDIGO. Madam Chairwoman, the proposal that we are having Peat, Marwick analyze for us we think is somewhat similar to your proposal, so I believe we are both thinking along the same lines in looking for a long-term solution to the program. I find those CBO figures very interesting. We look forward to having an opportunity to further analyze them. We hope that Peat, Marwick will be able to provide similar cost figures when they analyze the various options that would be available for an insurance program.

Miss KAPTUR. All right, and you expect their estimates to be in by August or September?

Mr. PEDIGO. That's the deadline that we have set for them.

Miss KAPTUR. I wanted to ask Mr. Buchman, I note in your testimony you object to releasing the veteran from liability as well, should he default, because the veteran should, in your words, "share the risk." Isn't it a sufficient sharing of the risk to lose your home and all you have invested in it?

Mr. BUCHMAN. I am also a veteran, Miss Kaptur.

Miss KAPTUR. Good.

Mr. BUCHMAN. I think from a philosophic and legalistic point of view—I am not a lawyer—and also from an equity point of view, we believe that it would be unfair to those who do follow the rules, so to speak, to then release those others. I think it is just more businesslike, or it would be very unbusinesslike to follow the proposal.

Skipping over to Professor Edelstein's proposal, one philosophic difference which I have with it, although the professor and I are both from Los Angeles and good personal friends, is that there is only one side to it. In a similar way, we feel it is not equitable to have sharing on only one side and not the other.

Miss KAPTUR. If that is the case, what would you recommend in order to have a shared risk? How would you adapt this proposal?

Mr. BUCHMAN. I am not sure I agree with the concept of the shared risk in the first place.

Miss KAPTUR. I wanted to go to Mr. Plutzik, if I could, just for a second.

In last February's statement before the House Budget Committee you said that the Government received more money through recourse sales. Do you still believe this?

Mr. **Plutzik**. I am not sure in what context I made that statement. Let me say—

Miss **Kaptur**. It was your testimony dated February 24th, and First Boston said, based on its analysis of the fiscal year 1987 experience with the asset sale pilot program, there were three conclusions that were given to the Budget Committee, the third one being that the Federal Government's financial return on nonrecourse sales had yielded a fair present value for the sold assets. "Federal agencies ought to be encouraged to engage in such asset management," and you ended with the sentence, "Selling these assets on a recourse basis would likely increase the Government's return, but recourse sales would not achieve the other programmatic and management benefits of the nonrecourse sales."

Mr. **Plutzik**. I feel very comfortable having made that statement, today as well. We continue to believe that the Government has received fair value for the sale of its assets; that there are benefits beyond quantitative ones achieved, as well.

Miss **Kaptur**. Since you state that the stand-alone investment value of the existing portfolio of vendee loans is viewed as being well below 90 percent of their unpaid balances, what figure do you envision the portfolio will receive?

Mr. **Plutzik**. I am not sure I am comfortable giving you a response today on that, insofar as we are in the midst of a discussion and transaction with respect to these vendee loans. Perhaps I could defer to Mr. Markus, who is financial advisor to VA.

Mr. **Markus**. I have here, and certainly we have copies available, the prospectus for the transaction that is expected to be executed in the next several days. Perhaps I could briefly describe the nature of the transaction and give you a sense of what is being done there and what full value, if you will, is being achieved.

Traditionally in U.S. Government asset sales the method of approach has been what we refer to in the industry as a senior subordinated transaction. Such a transaction provides for the creation of two sets of obligations. One is a senior security which represents a very high grade, nonspeculative investments, and then a junior or subordinate security. The sum total, in our belief, of the two securities—for one of which, the first one, the senior securities, VA receives cash in the ultimate sale. The other of which VA receives what we have called a contingent asset—is, as Jonathan indicated, fair value.

I would like to give you a sense of the relative proportions in the first transaction, which is a very, very unique transaction for the capital markets. First, however, let me try to tell you a little bit why it is so unique. There has never been a transaction before that represents fully on properties that have previously been foreclosed. There has rarely been a transaction before in the capital markets that represents totally loans that are in excess of 90 percent loan to value, with a fair amount of those loans being at 100 percent loan to value, throughout the country. There has rarely been a transaction that represents 26 percent Texas risk and about 15 percent California. Most transactions tend to be more widely dispersed.

With those criteria and the history of the delinquency, defaults, loss experience of the VA, the level of subordination, if you will, projected in this particular transaction—and that would shift based on the makeup of the portfolio, depending on where it comes from—is 34 percent. So we expect to be selling the following in the transaction: Sixty-six percent of the principal amount of the loans *will be sold in senior certificates* which will be sold at triple A rates, and 34 percent subordinate certificates will be held with the VA.

If I could analogize it a little bit, it is similar to the concept of the "no-bid" amount. What you have here is, in this nonrecourse sale, what we have effectively done is capped the exposure, if you will, of the VA. By taking back a contingent asset, we have been able to make sure that that asset, that the cash flow of that asset flows to the VA fund. So a long-winded answer, I think, to your question, but what we are going to receive here is fair value in the form of proceeds from the senior certificates and subordinate certificates.

Miss KAPTUR. Could you tell me, how are fees and commissions calculated in terms of what is actually returned to the Government?

Mr. MARKUS. Well, there will be fees and commissions on the senior certificates. On the subordinate certificates there are no fees and commissions, and those are standard fees and commissions in any mortgage-backed triple A transaction. Obviously there are also some startup costs in creating what I believe may be the thickest prospectus ever to hit the street on a mortgage-backed securities transaction.

I think you will find probably the most complete description of the VA vendee loan program ever put together in any document in this particular document, and that involved, for example—to give you a sense of the due diligence involved in putting together this transaction—every one of the stations in the VA program filled out a questionnaire as to their origination procedures, as to just what happens when a property becomes foreclosed and how it gets to become a vendee loan. An extensive amount of work was put in to create this nonrecourse vendee loan model.

Miss KAPTUR. I just wanted to ask Mr. Pedigo, for the record, as VA looks at the future of this program, what types of alternatives you are considering internally, to the extent you can discuss them this morning?

Mr. PEDIGO. Well, the major alternative that we are considering now is the mortgage insurance study that Peat, Marwick is conducting for us. Over the program's history, we have always made technical corrections to the existing program to try to address specific problems that come up, but at the present time we are also looking for long-term solutions. We realize, as you do, that there are no quick fixes for the financial problems that we have in this program, and that is why we are looking at the various options that might be available in an insurance program. That is the primary alternative that we are looking at the present time.

We have been making changes to every part of our program. We improved our credit standards in October of 1986 and then again in February of this year. We have made very significant changes in our appraisal process over the last 18 months, a very significant change being made 2 weeks ago when we gave 13 of our field stations a deviation from existing appraisal practices that we think will result in more cost-effective assessments of whether or not we should take a property back at foreclosure. We have made numerous changes in our loan service and claims operation over the last 2 years to try to improve our servicing of these loans and reduce the Government's costs, and we have made changes in the property management area which in fiscal year 1988 resulted in the most sales that we have ever experienced in the history of this program.

So we are making minor technical corrections to the existing program, but we are looking to the long term.

Miss KAPTUR. And it's long-term that I am interested in. I am asking you, are there any major policy directions that you see yourself moving in, or is the mortgage insurance the only one?

Mr. PEDIGO. That is the only one that we are looking at at the present time.

Miss KAPTUR. All right. I know there is a woman in the audience by the name of Nina Shepherd from the Congressional Budget Office, who is not listed on our formal agenda today. I would ask, if she is in the audience, if she might come up and speak into that microphone over there, purely for the purpose of giving us some numbers that are available to her. I am going to be asking her about the costing out of the mortgage indemnity proposal that we have offered in the committee.

We welcome you this morning, Ms. Shepherd. Just for the benefit of the members of the committee and the witnesses and guests who are here, am I correct in my interpretation of the CBO cost estimate, that under the indemnity proposal offered by this committee there would be a surplus of monies in both the old and the new housing funds after 10 years?

Ms. SHEPHERD. Based on my analysis, that is correct. However, you must understand that when you are estimating 10 years into the future, you are dealing with a large amount of uncertainty, particularly when the economic conditions have such an enormous impact, as they do on this program. My estimate basically holds things steady after 1993. But under those circumstances, yes, both funds should have an unobligated balance within 10 years.

Miss KAPTUR. Would there be a surplus in either fund earlier than the 10-year threshold?

Ms. SHEPHERD. Yes, there would. There would be a surplus in the mortgage indemnity fund from the beginning, although outlays would be positive after 1991. There would be negative outlays initially, but there would be some small surplus from the Government's contributions. In the Loan Guaranty Revolving Fund, a surplus would be expected to begin around 1993.

Miss KAPTUR. In 1993? Thank you very much. Now do you also have numbers on the level of appropriations that would be needed to sustain the existing revolving fund over the next few years. Do you have those numbers available to you?

Ms. SHEPHERD. Yes, I do.

Miss **Kaptur**. I really think the committee would benefit if you could give us those numbers, so we get a sense of the magnitude of the shortfall that we are dealing with here.

Ms. **Shepherd**. Under current law, which would require that VA return to selling loans with recourse in 1990 and under which the loan origination fee would expire after 1989, VA would be expected to need appropriations of around $2 billion a year, including both the deficiency appropriation and the borrowing authority that would be required for the loan asset sales with recourse.

Miss **Kaptur**. In your opinion, could that program ever reach a break-even point?

Ms. **Shepherd**. Under those circumstances, no, I don't expect that it would.

Miss **Kaptur**. If you could just wait by the microphone there for just one second, I wonder if Mr. Pedigo or Mr. Vogel or any of the witnesses this morning have anything they wish to state at this point?

Mr. **Pedigo**. I think that we would like to have an opportunity to analyze those figures. It's rather difficult to comprehend the impact of them at this point without some in-depth analysis on our own, by our own staff.

Miss **Kaptur**. I will say to Ms. Shepherd, every head in the room turned toward you. There was complete silence. We do appreciate the extra effort you made to have those numbers available for us this morning, and I know many people will be contacting you, including this committee.

Dr. **Rowland of Georgia**. Madam Chairman, may I ask a question?

Miss **Kaptur**. Certainly, Dr. Rowland.

Dr. **Rowland of Georgia**. There would be a $2 billion deficit in those loans with recourse?

Ms. **Shepherd**. There would be a $2 billion appropriation required.

Dr. **Rowland of Georgia**. Needed to keep the fund solvent, so that means there would be that much money that would have been lost.

Ms. **Shepherd**. That is correct.

Dr. **Rowland of Georgia**. Why is that? I mean, is there that much default on the loans, or—

Ms. **Shepherd**. A lot of it is because the origination fee would not be extended under current law. Under current law, the origination fee expires at the end of 1989. Also under—

Dr. **Rowland of Georgia**. That is the 1 percent.

Ms. **Shepherd**. That is correct. Also, under current law VA would be required to resume selling loans with recourse. When loans are sold with recourse, they are considered the equivalent of borrowing from the public, so budget authority in the form of borrowing authority would be required in an amount equal to the amount of loans that are sold. In addition, the proceeds from those sales would not offset the outlays of the Loan Guaranty Revolving Fund, as they would if the loans were sold without recourse.

Dr. **Rowland of Georgia**. If the origination fee was extended, do you have a projection about what it would be?

Ms. **Shepherd**. The origination fee is expected to run around $200 million in collections, under my estimate, in the next few years.

Dr. **Rowland of Georgia**. There is a very large default rate, then, isn't there?

Ms. **Shepherd**. That is correct. There is a fairly large default rate under this program. But the VA in the past has sold around $800 million in loans every year, so a large amount of the budget authority that would be required under current law when loans are sold with recourse would be the borrowing authority that is required for the recourse loan sales.

Dr. **Rowland of Georgia**. Thank you, Madam Chairman.

Miss **Kaptur**. I just wanted to state for the record that we have had to request two appropriations over the past year, the first in the amount of $389 million, and then just a few weeks ago in the supplemental appropriation for the remainder of this year, $525 million for the Loan Guaranty Fund in order to keep it solvent.

There are a number of reasons that it has reached that condition. It is not, for the most part, due to borrower default. There are several reasons, including the fact that just as the thrifts got into trouble, there were a number of loans made at very high interest rates. There is a higher level of default on those, that's true, so part of the defaults are due to the conditions of the time.

Years ago, also, there was a direct loan program that operated and its earnings were put back into the fund. That was phased out over a period of time, and also because there have been so many sales of assets, there is less revenue coming into the fund, so many of the old systems that used to be in place to support the entire guaranty fund are no longer there, and so we are left with a system that is just hemorrhaging at this point.

We know that homeownership is a dream of all Americans, and this program has been such an important part of that dream. It built America after the Second World War, really, and then with FHA we built the suburbs. We are now faced with one of the most major changes that this program has had to face since its inception, in order to ensure its solvency.

But I think it is incorrect to think that it is only because we have veterans who aren't paying back their loans, that we are faced with this problem. It has to do with the internal financing of the program.

Do any of the witnesses wish to give us any insights that were not in your prepared testimony, or make any other comments at this point?

[No response.]

Miss **Kaptur**. Mrs. Patterson, did you have any questions?

Mrs. **Patterson**. Thank you, Madam Chairwoman. I appreciate the opportunity to hear from these gentlemen. I would like to just ask one question of Mr. Markus, if I might. Do you believe that VA has done an adequate job in the past of marketing its loan portfolio?

Mr. **Markus**. Once the loan is made, the actual loans, I think that this is the first nonrecourse sale, and that the recourse sale has been adequate, yes. That would be a word I would use. I don't know if I would use the word "exceptional," but "adequate," yes.

Mrs. **Patterson**. Just adequate, and you said that with hesitation, maybe?

Mr. **Markus**. No. I mean, I think that there are issues in the recourse sale and the way it has been conducted. For example, I think this is a problem Ginnie Mae has as a general rule, if you will. Every Ginnie Mae eligible mortgage banker is eligible to bid at the recourse sale. Therefore, you may not get the best servicers, and these are loans that need intensive servicing. For example, in the nonrecourse sale we went through an extensive process to pick the servicer for the trust buying these loans, and therefore we believe we have gotten the best servicer available to service these loans, in order to make sure that the proceeds are maximized over time, so that is just one issue that you cannot address in a recourse sale. That is why I used the term "adequate." I think it was a very adequate response to a very, very difficult problem.

Mrs. **Patterson**. Let me ask you another question, as we look at these proposals: Which do you think is more cost-effective in this type of program, a pool or bond insurance?

Mr. **Markus**. I'm not sure I understand the question.

Mrs. **Patterson**. Let me see if I can rephrase it. I guess maybe we should start back, and maybe you can explain to me—and I think maybe it was in a statement—explain the subordinate pool of loans and how it would operate. I guess that is what I am talking about, a subordinate pool.

Mr. **Markus**. Okay. What you have here is a term that we use in the industry, which is known as credit enhancement or additional support. You have a certain assumed level of delinquency, default, and what have you, and in order to get a high=grade, nonspeculative rating on the senior certificates, the rating agencies and any credit enhancers in terms of insurance will require certain stress tests, we call them, to be entered into in doing a transaction.

That stress test then translates to the level of senior certificates that we can sell in a transaction, and then to make sure—because those stress tests in any transaction, not just this portfolio, in any transaction, are very, very onerous, depression-like, worst case—we then take that stress test and how the deal works under that stress test, and we have been able to structure senior certificates and then junior certificates which are held by the VA if the portfolio—and I think this is very, very important, and why we think this is a very cost-efficient way and a smart way to proceed—if the portfolio performs better than the worst case assumed by the investing public, then that better performance accrues to the benefit of the VA, so that is the way a nonrecourse transaction is structured. If it performs worse than that assumption, then the investor is taking the loss.

That is the key to the difference between the recourse sales that have been initiated before, where every loan in that portfolio conceivably could be bought back by the Veterans' Administration over time, versus you set a percentage here, it performs better, the up side is VA's; it performs worse, the down side is the investors'. Therefore, we think that is a very prudent way to approach this particular sales effort.

Does that help you?

Mrs. **PATTERSON**. That helps you, and I appreciate your using terms that I might understand, and the good doctor might, "stress test." I think that is what we are all talking about.

Mr. **MARKUS**. Well, that's what we call it, and believe me, they are a lot tougher than the doctors' stress tests.

Mrs. **PATTERSON**. Well, then, I think what we are all looking at is the stress test on our veterans as we deal with this problem.

Dr. **ROWLAND OF GEORGIA**. It shows where his heart is. It's not with the person's health but money, right?

Miss **KAPTUR**. That reminds me of someone who once told me, in trying to get people to be able to afford homes the challenge wasn't so much to fix up or to rehabilitate the house, but to rehabilitate the person's credit to get in the house in the first place, so we are happy to hear the improvements that the VA is making in program management to work with the veteran and to deal with the outer edges of the program and some of the proposals we had made here in our bill last year, to help the veteran hold onto the house rather than have it lost.

I wanted to thank Ms. Shepherd very much. You are welcome to sit down. I know that your information will be used by many people here.

I apologize to the witnesses who are waiting for keeping this panel so long. We really did want to hear from them this morning.

Dr. Rowland, you had an additional question.

Dr. **ROWLAND OF GEORGIA**. Yes, I do have one additional question. You mentioned some of the reasons for the guaranty program being in difficulty, and one of them was a changing in interest rates. Let me ask you this, if you may: What is the fixed-rate, 30-year mortgage rate now, a ball park figure? About where is it?

Mr. **PEDIGO**. The VA rate is 10.5 percent.

Dr. **ROWLAND OF GEORGIA**. No, I am talking about outside of the VA.

Mr. **PEDIGO**. Outside of the VA it's a little above 10.5 percent. Ten and seven-eighths is an oft-quoted figure.

Dr. **ROWLAND OF GEORGIA**. What about points now? I know that varies from day to day, but—

Mr. **PEDIGO**. Right now VA transactions are requiring about anywhere from a point to no points at 10.5 percent. We are really in a par market, and have been for the last 4 to 5 business days.

Dr. **ROWLAND OF GEORGIA**. And outside the VA?

Mr. **PEDIGO**. Outside the VA, because of the numerous types of financing twists that are out there, you find points ranging anywhere from 1 to 3 in most transactions.

Dr. **ROWLAND OF GEORGIA**. Let me ask—go ahead.

Mr. **MARKUS**. It should be pointed out that the mortgage market, since the advent of the early eighties, is very, very eclectic. There are very many opportunities. Thirty-year, fixed-rate money, if you will, what we call "conforming," which means Fannie Mae and Freddie Mac conforming, is the only product that is sort of homogenous, and that probably goes from 1 to 3 points, but if you begin to talk about jumbo loans and everything else, it is really all over the lot.

Dr. **ROWLAND OF GEORGIA**. What do you mean, "jumbo loans"?

Mr. MARKUS. Above the limits that Fannie Mae and Freddie Mac will buy, which today I think is $172,000 or something.

Dr. ROWLAND OF GEORGIA. Let me ask you one other question, and this is asking you to speculate: What do you anticipate long-term mortgage loans to do over the next year or so?

Mr. PEDIGO. Well, I am flattered that you asked me that.

[Laughter.]

Mr. PEDIGO. If I could give you a good, solid answer, I probably wouldn't be sitting at this table today.

Dr. ROWLAND OF GEORGIA. Well, I don't want a solid answer. Just speculate.

Mr. PEDIGO. It appears that, well, as Mr. Markus said, we are in an eclectic market. It fluctuates up and down. It is really difficult to say what it is going to do in the long term, but it appears that the Federal Reserve is determined to keep inflation in check, so it is my guess that rates will probably remain in the 10 to 11 percent range in the near term.

Dr. ROWLAND OF GEORGIA. What is the lag time between what the Federal Reserve does and before it filters down to long-term mortgage loans, generally speaking?

Mr. MARKUS. Ten seconds.

[Laughter.]

Dr. ROWLAND OF GEORGIA. Really?

Mr. MARKUS. Yes. With the securitization of the market, you know, and the Ginnie Mae price, I think that's about the lag time.

Dr. ROWLAND OF GEORGIA. It's almost immediate, then?

Mr. MARKUS. Yes, and if I can answer your earlier question about interest rates, my answer is, ask First Boston.

[Laughter.]

Dr. ROWLAND OF GEORGIA. Your answer is what?

Mr. MARKUS. Ask First Boston, my friend Jonathan. I'm just kidding.

Miss KAPTUR. They securitize more of the mortgage-backed securities—right?—than any other company in America. Is that a correct statement, or you are one of the top?

Mr. PLUTZIK. One of the top. I think my friend Marvin was just trying to duck the question, rather than give me a compliment.

[Laughter.]

Miss KAPTUR. You know, Dr. Rowland, you asked some very important questions there about competitiveness of the VA program compared to the private sector programs. In my own district we have looked at this very closely, and found that it isn't a question of rates—the VA always scores very well on rates compared to other opportunities—but processing time and the ease with which one can go to a private-sector institution and get a loan, which can take a few days, a week at the most, versus—and again, I am only speaking of my own area—where it may take 6 weeks to get something processed, 3 weeks in a good period. We are looking for ways to try to streamline the program and to make it operate more efficiently, because the rates still are very good.

Dr. ROWLAND OF GEORGIA. Well, that is certainly a lot better than it was 2 years ago, when it took 4 or 5 months to get one processed.

Miss **Kaptur**. All right. There are no further questions of this panel, then, from Mrs. Patterson or Dr. Rowland?

[No response.]

Miss **Kaptur**. Thank you, gentlemen, very much for your testimony this morning. We look forward to working with you, Mr. Vogel and Mr. Pedigo, on refining these proposals before the summer is out.

Mr. **Vogel**. Thank you, Madam Chairwoman.

Miss **Kaptur**. I would like to call the next panel, please, representing the various veterans' organizations: Mr. Richard W. Johnson, Jr., director of Legislative Affairs, Non Commissioned Officers Association; Mr. Dennis Rhoades, director, National Economics Commission, The American Legion; Mr. Stephen Edmiston, deputy national legislative director of the Disabled American Veterans; Mr. Dennis Cullinan, assistant director, National Legislative Service, Veterans of Foreign Wars; and, finally, Mr. John Bollinger, the associate legislative director of the Paralyzed Veterans of America.

We thank you gentlemen for waiting this morning, also for all having your testimony in prior to the hearing, and we would welcome your comments. Mr. Johnson, you are listed first on the agenda and we welcome you back to this committee.

STATEMENT OF RICHARD W. JOHNSON, JR., DIRECTOR OF LEGISLATIVE AFFAIRS, NON COMMISSIONED OFFICERS ASSOCIATION

Mr. **Johnson**. Thank you, Madam Chairwoman. We appreciate the opportunity to be here.

NCOA commends the committee on its initiative in bringing forth this new program for discussion. As may be noted from our prepared statement, NCOA is not overly enamored of the mortgage indemnity proposal. Frankly, we don't believe the Loan Guaranty Revolving Fund is beyond salvation. Notwithstanding the past initiatives of the committee, it appears that OMB and others no longer want to salvage loan guaranty in its current form, or just believe that it is totally infeasible, and therein, in the direction we are heading right now, is something of a shame on all of us.

I watched the testimony this morning, and it amazes me, quite frankly, how a temporary half percent loan fee that was instituted some years ago is being talked about in very permanent terms now, in very permanent terms, such that it is never going to go away again, that there will always be a fee associated with the benefit of a veteran's home loan, something that did not have a fee on it until just a few years ago.

With that understanding, NCOA tentatively and, as previously stated, somewhat reluctantly endorses the current proposal with several recommendations. First, we ask that the fees be set at 1 percent each. The CBO numbers seem to suggest the feasibility of doing this. Veterans have been punished enough through Government's failure in the loss of the current loan guaranty program and there is, in our estimation, no particular reason why we couldn't set the fee at 1 percent.

We are not giving the veteran anything for his 1 percent now. We are trying to convince the veteran that he is going to get mortgage indemnity for the additional quarter percent he pays, but that still leaves that 1 percent hanging out there, as to what he is doing with it.

Quite frankly, there are two benefits in the program in the first place. The no money down aspect of the loan and the 30-year guaranteed fixed interest rate of the loan are the benefits by which most veterans will profit in the program. The only people who are going to benefit on mortgage indemnity are those who default. As a result, we think a 1 percent fee or retaining the 1 percent fee limit would be very equitable.

Second, we would like to see—and our support is really contingent on this—we want to preserve the provisions to exempt disabled veterans from having to pay any fee at all.

Third, we would like for the committee to specify in legislation that veterans' fees should be suspended or eliminated when sufficient reserves have been established, and concurrently provide that Government contributions may not be reduced until such veterans' fees are ended, suspended or eliminated.

As a matter of investment, we would like to see the committee authorize direct loans. In addition to investing in T-bills or whatever other assets the Secretary of the Treasury wants to invest in, some of the reserves of the program, in our estimation, would be well served to be put back into a direct loan program which could produce a better revenue in the long run than a T-bill could.

Miss **Kaptur**. May I interrupt you, Mr. Johnson, to say I was very surprised that none of the testimony—none—that we received offered any proposal to resume a direct loan program. I think that is correct. I read most of it last night. Maybe somebody did, but I didn't remember that.

The DAV did say that, Mr. Edmiston?

Mr. **Edmiston**. We did.

Miss **Kaptur**. All right.

Mr. **Johnson**. And we did also. We asked for direct loans under the new program, but I think that the long-term success of the program lies in getting back into direct loans because they produce money for operations.

Finally, we would like to reassess the viability of the Mortgage Indemnity Fund at the end of 5 years and look at, particularly based on the CBO figures, a possible merger of the programs as something that might then again be economically feasible.

Finally, we would like for the committee to express its leasing and rental initiatives in law rather than in terms of a sense of the Congress resolution. We understand that the committee perceives that to be micromanagement. Nevertheless, we believe that the Veterans' Administration would be strongly encouraged by that kind of micromanagement and it would be good in the long run for the program.

We have also been asked to comment on equity sharing this morning. We don't think much of equity sharing, quite frankly. We addressed it well in our statement. I think Mr. Vogel of the Veterans' Administration covered the issue very well in his prepared testimony, in his oral testimony this morning, and we would endorse the VA's position on equity sharing.

Thank you.

[The prepared statement of Mr. Johnson appears on p. 91.]

Miss Kaptur. All right. Thank you very much.

Mr. Rhoades, we will move on to you.

STATEMENT OF DENNIS K. RHOADES, DIRECTOR, NATIONAL ECONOMICS COMMISSION, THE AMERICAN LEGION

Mr. Rhoades. Thank you, Madam Chairwoman.

We identify with many of the remarks my colleague from NCOA has made this morning. We are very pleased to see this committee taking the leadership to deal on a long-term basis with a very serious problem. I think we have all in the past sort of ducked around this issue. The CBO representatives estimate of the requirement for a $2 billion appropriation is quite sobering and points to the fact that we need to seek some real positive long-term solutions.

I am not going to go through those points that we made in our testimony, summarizing what we said last March. I do want to mention, however, primarily for emphasis, that the Home Loan Guaranty Program is, first and foremost, a veterans' benefit. We disagree with the attitude expressed by some of the witnesses, particularly Mr. Buchman, who does not agree that the Government ought to share the risk in the home loan business with the veteran. We think that is the purpose of the program. If concept is eliminated, then you have defeated the purpose of the exercise.

We also believe that this subcommittee well recognizes that there are no quick fixes to this program. Policy changes regarding appraisals, underwriting standards, and property management, are fine, but they do not get to the root problem, and that problem is that either the Loan Guaranty Revolving Fund is going to require a permanent appropriation in the VA budget, or an alternative income source must be found.

Turning to the mortgage indemnity proposal, as you have probably been able to infer from our testimony, we are intrigued by the concept. Although the proposal will impose an additional fee on the veteran buyer and we have traditionally said that we do not like the idea of the veteran paying for his benefit—we do think that the fee will at least pay for something. That is, it will buy indemnity in the event of a default and foreclosure. We think that is probably the strongest single element in the proposal which recommends it to us.

Thus, we believe that the indemnity proposal in this draft legislation has considerable merit. We agree with Mr. Johnson and some of the other witnesses that no fee should be charged to the service-connected disabled veteran, in order to maintain the same kind of relationship as we have with the current user fee.

We do believe that, should this proposal or a similar proposal be adopted by the Congress, the Congress must also clearly recognized that there are going to have to be substantial appropriations to pay for the old program for the next several years. What the subcommittee is asking Congress to do—and what Congress must do—is bite the bullet. There is no way that the VA home loan program is not going to cost the Government money, and we might as well accept it. The question is, is it going to cost the Government money ad infinitum or is there to be some closure to the problem? We feel that proposals like the mortgage indemnity proposal will put us a long way down the road toward dealing with the loan guaranty deficit problem.

We are somewhat concerned about the fund itself. We believe that the fund must be insulated from deficits arising from foreclosures on loans guaranteed prior to the enactment of the legislation. We think this proposal in essence does that, but we are also very concerned about having money sitting over at Treasury which may be a great temptation to budget cutters, both here on the Hill and in OMB, we are looking for short-term offsets.

As you are well aware, the pot of money that we had with the direct loan program, in terms of the assets, was sold off. Particularly in an era of the very tight budgets and high Federal deficits we are experiencing now, it is going to be a temptation which we need to guard against. Therefore, we would suggest that the subcommittee examine making that fund a trust fund and affording it some additional protection.

We want to conclude our statement by discussing the equity-sharing proposal developed by Professor Edelstein. As we indicated, we find that his diagnosis of the problem is quite accurate but the cure unreasonable from a public policy and entitlement perspective. We find particularly distasteful the suggestion that there should be an inverse relationship between the amount of equity to be shared and the initial downpayment made by the veteran buyer. We think that suggestion is directly at odds with the whole purpose of the program: to provide those veterans with little credit history or capital with the opportunity to own their own homes. We are also concerned about how this program could possibly be budgeted. How do you know what somebody is going to earn when they sell their house?

Madam Chairman, that concludes our statement.

[The prepared statement of Mr. Rhoades appears on p. 95.]

Miss KAPTUR. Thank you, Mr. Rhoades, for a very thoughtful statement.

Mr. Edmiston, welcome back.

STATEMENT OF STEPHEN L. EDMISTON, DEPUTY NATIONAL LEGISLATIVE DIRECTOR, DISABLED AMERICAN VETERANS

Mr. EDMISTON. Thank you, Madam Chairwoman.

It is a pleasure to be here this morning on behalf of the 1.2 million members of the DAV and its Ladies' Auxiliary to comment on the proposals pending before the subcommittee. I would like to just briefly highlight some of our written testimony, specifically with respect to the major proposal, the indemnity fund.

We would like to recommend that the subcommittee consider, in addition to the indemnity fees and the VA's contribution and so forth that the bill proposes, that the fund would also receive any and all funds, fines, settlements, penalties that would be collected as a result of any fraud that has occurred in the loan guaranty program. We would also like to echo Mr. Rhoades' comment in terms of protecting that fund from OMB raiders.

I would like to spend a little time also discussing the fee that the legislation would require veterans to pay. We are disappointed that service-connected disabled veterans would be required to pay that fee. While we recognize that the bill would produce a significant benefit and protection from liability as compared to the present fee, which provides absolutely nothing, we are very much opposed to requiring our Nation's service-connected disabled veterans to pay for this earned benefit entitlement. Our support for the bill really hinges on that whole point. Quite frankly, we could not support such a program if service-connected veterans would be required to pay that fee.

With respect to the other draft bill, we fully support its provisions but I guess I would echo Mr. Johnson's comments, with respect to the sense of the Congress resolution portion of that draft, that it be included in the law rather than a sense of Congress. We realize there is a concern of micromanaging here, but the track record is such that has been dictated by OMB, that we don't believe they will take it very seriously.

With respect to Professor Edelstein's proposal, I don't think there is any doubt that he is sincere in his effort to seriously look at the program, and I think the development of his proposal is one that he believes has a possibility to address the long-term problems of the program, but quite frankly we don't see the same value in his proposal that he does. Quite frankly, I think it would lead to the demise of the program rather than to its solvency.

Then finally I would just like to conclude by saying that generally we are pleased to see some of the proposals, particularly the two draft proposals, with the exceptions we have noted in our written testimony, but we still think that there are two other areas that need to be addressed. One we think is vitally critical, and that is the staffing of the loan program itself. Quite frankly, if you don't have the personnel to do the job, you can't expect the program to get a whole lot better. The other, of course, is increasing the authorization with respect to direct loans.

With that, I would like to conclude my statement, and I again thank you for the opportunity of being here this morning.

[The prepared statement of Mr. Edmiston appears on p. 101.]

Miss KAPTUR. Thank you, Mr. Edmiston. While you were testifying I asked if our very capable staff couldn't tell me how many service-connected veterans participate in the program, because it hadn't been in any of the testimony. It's about 6 percent. Certainly all of you have recommended we take a very close look at that, and we will do that as we move forward with the bill.

Mr. EDMISTON. We appreciate that very much. Thank you.

Miss KAPTUR. We are hearing you on that.

Let me see. Who is next here? Mr. Cullinan.

STATEMENT OF DENNIS M. CULLINAN, ASSISTANT DIRECTOR, NATIONAL LEGISLATIVE SERVICE, VETERANS OF FOREIGN WARS OF THE UNITED STATES

Mr. CULLINAN. Thank you, Madam Chairwoman. On behalf of the entire membership of the Veterans of Foreign Wars, I wish to thank you for inviting our participation in this hearing today.

The first bill we are going to talk about is the Veterans' Home Loan Mortgage Indemnity Act of 1988. This proposal represents an attempt to essentially create a new home loan program. In this regard it is our contention that the current program's problems are directly due to OMB having forced the program to sell off a large portion of its best loan assets in past years. We still contend that if the program were allowed to rebuild its portfolio of vendee loans, it would eventually become once again self-sustaining. However, we also acknowledge that in all likelihood this could take from 10 to 15 years, and we are painfully aware of the large appropriations now required to keep the program running.

The VFW favorably notes that the 1.25 percent indemnity fee that would be charged veteran borrowers in place of the current origination fee, would in turn release these individuals from liability in the event of default. We, too, would make a special note that we believe disabled veterans should be exempted from the fee.

Even though we have some concern as to yet unforeseen implications this proposal may have for the program, VFW strongly supports the implementation of a mechanism for releasing veterans from financial liability in the event of foreclosure. Taken as a whole, the VFW views this legislation to establish a new and financially independent home loan program as a bold and innovative initiative which is certainly moving in the right direction toward fulfilling a VFW mandate, that legislation be introduced and carried out that will serve to maintain the VA Home Loan Guaranty Program as the most viable and desirable means of home financing for veterans.

The next bill we will comment on is also proposed legislation. The first section of this bill provides that the Administrator may sell a vendee loan without recourse, but only if the amount received is equal to 90 percent of par value.

The VFW continues to strongly support the VA selling its vendee loans without recourse, since this minimizes the program's financial exposure. However, we also recognize that loans sold without recourse do not command as much money as those sold with recourse, and that this can result in the VA home loan program losing money. This is especially true if, say, OMB were to force the VA to sell off a large portion of its vendee loans without recourse at a drastically discounted rate, in order to realize a one-shot infusion of deficit-reducing revenue. Needless to say, this has a very harmful consequence for long-term functioning of the program. VFW appreciates the intention behind Section 1 and supports its enactment.

Section 2 of this draft legislation is a technical amendment addressing the computation of entitlement, allowing for easier refinancing, and we support this amendment.

Section 3 modifies the criteria for regulating the waiver of recovery of claims by the United States in the veteran's favor, and the VFW supports this, as well.

Finally, Section 4 of this bill conveys the sense of the Congress that the VA should refrain from disposing of foreclosed real properties through auctions, and should concentrate on disposing of such properties through conventional methods of sale. This section also asks that such properties, where appropriate, be leased.

The VFW has testified on numerous occasions in the past that it is of paramount importance for the VA to reduce the amount of time it holds real properties, and we readily acknowledge that the recommendation to lease these properties may well have merit. Even so, we do have some reservations as to whether the VA should become involved in the rental business. We believe one possible solution to this problem would be for the VA to subcontract with local rental and leasing agencies to run the nuts and bolts operation in various affected areas. Not only would this ameliorate any perception that the VA is in competition with the private sector, but it would also spare the VA from having to establish a mechanism to look after and run a leasing, rental program.

The last issue under discussion today is Professor Robert Edelstein's shared equity proposal. Our prepared statement fairly well addresses and particularizes our objections to this proposal. Essentially we view it as being unfair, and additionally flawed in practical terms. We see that it could eventually lead to the total demise of the program, and we therefore strongly object to it.

With that, I will conclude my statement, Madam Chairwoman.

[The prepared statement of Mr. Cullinan appears on p. 105.]

Miss KAPTUR. Thank you very much, Mr. Cullinan.

Finally, I would like to call on Mr. Bollinger.

STATEMENT OF JOHN BOLLINGER, ASSOCIATE LEGISLATIVE DIRECTOR, PARALYZED VETERANS OF AMERICA

Mr. BOLLINGER. Thank you very much, Madam Chairwoman. It is a pleasure for me to be here today and present the views of Paralyzed Veterans of America.

Miss KAPTUR. Good to have you.

Mr. BOLLINGER. When this subcommittee last held hearings in March concerning the solvency of the loan guaranty program, it was with a certain degree of urgency that we discussed the critical condition of the Loan Guaranty Revolving Fund. Since that time, Congress has once again rescued the fund by approving emergency aid.

There seems to be little doubt that the long-range solvency of the program faces continued problems unless the VA, the Congress, the veterans' service organizations, and program participants come to grips with the gravity of the situation. Our collective mission must now be one to save the program. We must be willing to accept change, and to even alter the basic program which has, over the years, made homeownership a reality for over 12 million veterans.

Regarding the Veterans' Home Loan Mortgage Indemnity Act of 1988, PVA is in agreement with the intent of this draft legislation. The establishment of the indemnity fund and the 1.25 percent fee lies at the heart of this program. PVA has historically opposed the administration's efforts to increase the existing 1 percent funding fee. In addition, we have supported any proposal which provides an exemption to the fee for veterans who are in receipt of service-connected compensation.

An exemption to the proposed 1.25 percent indemnity fee for these individuals would represent a welcomed enlargement of the total benefit package. However, PVA will not object to the collection of this fee for all program participants, including those in receipt of compensation, if it is determined that such exemptions would mean the difference between success and failure of the program.

We believe the indemnity fee represents a good investment in an individual's financial security, as well as contributing to the overall fund. For a comparatively small premium, one is protected from financial devastation due to the indebtedness of a defaulted home loan. Coupled with the Government's contribution of a quarter percent premium for 3 years, the total fund, including the Treasury's investments, should be sufficient to offset future losses incurred by the VA in connection with the foreclosure of guaranteed loans.

PVA continues to be skeptical about renting certain foreclosed properties until market conditions improve. As the administration's assaults on staffing levels continue to mount, we ask whether the VA can truly operate an additional program to rent properties in areas that are, for the most part, already economically depressed. Although this concept has some appeal, we cannot imagine the VA managing such a program, given the present staffing levels and existing resources.

In lieu of renting foreclosed properties, the VA must aggressively pursue sophisticated marketing techniques to sell such properties. In addition, we believe reinforced efforts must be made to avoid foreclosures in the first place. Special emphasis should be placed on counseling assistance, to assist delinquent borrowers in retaining ownership of their homes.

Regarding the sale of vendee loans, PVA believes the proposed legislation properly addresses this issue. The Government's return will be maximized if vendee loans are sold with recourse. By allowing the sale of the loan portfolio without recourse, but only if 90 percent or better is received, the VA has some degree of flexibility without selling at outrageously low prices.

Regarding the shared equity proposal under consideration today, the intent of the proposal and quite possibly the short-term effect of such a system does represent a thoughtful and sincere effort to establish program solvency. PVA, however, simply does not support ex post fees directed at economic winners to accomplish this end. We feel certain that the prospect of having to share a predetermined percentage of equity gain with the VA loan guaranty program would prove to be so unpopular that veteran home buyers would seek conventional or FHA financing instead of VA financing.

Whatever changes are ultimately enacted in the VA loan program, we believe they should apply equally to all and be known up front to the prospective home buyer.

Madam Chairwoman, that concludes my testimony.

[The prepared statement of Mr. Bollinger appears on p. 108.]

Miss KAPTUR. Thank you, and I thank all of you. As I was sitting here listening to your testimony I wondered, in your respective positions within your organizations, whether you ever thought you would be spending this much time on housing.

[Laughter.]

Surprise. We are certainly happy to have you all here.

I wanted to ask first of all, Mr. Johnson, in your testimony you referenced—and you were the only one—something called the Veterans' Mortgage Bonds Program as another option that this committee might look at. At this point in my mind, though we are seriously looking at the indemnification proposal, I am still open to new proposals for the future in this program. I couldn't really understand what you meant by it. There wasn't a lot of detail, however.

Mr. JOHNSON. No, and I don't have a lot of additional detail to offer. What we were speculating on when that provision of the statement came up was, a number of States have provided public financing of housing programs for veterans and for others through the issuance of State-supported bonds, the interest difference of the bond versus the interest difference of the loans paying for the price of the program, and of course there would be certain tax advantages to the investment in the bonds at the State level, in that they would be exempt from State taxes, the investments would be exempt from State taxes, and so forth.

At one point in time there was actually a Veterans' Mortgage Participation Certificate on the national level, as I understand it, which—

Miss KAPTUR. That was before my time.

Mr. JOHNSON. Well, it was before a lot of our times, Madam Chairwoman, but there was in fact a chance to buy into an investment in that program, and that was a public financing door that was closed, I think, sometime in the early sixties. Counsel may well know what I am talking about in that, but in any event, public financing is not beyond reach. If we could sell a bond at T-bill or near T-bill rate, convert that money into a direct loan program, use the assets and the income from that direct loan program not only to pay off the bonds but perhaps to finance the program in and of itself, I think we would be doing the veterans a major service.

Miss KAPTUR. I understood that California had some type of a veterans' mortgage bond program.

Mr. JOHNSON. A very successful mortgage bond program.

Miss KAPTUR. Mr. Rhoades, do you know about that?

Mr. RHOADES. Yes, I am a native Californian. The program is called the Cal-Vet Program. It has never cost the taxpayers of California a penny, and it has operated since World War II. Its interest rates are lower than the conventional rates. Its only drawback, of course, is that it is so popular. There is a dollar ceiling that is reached, so there tends to be at various times a waiting list to get a Cal-Vet loan approved. It has been a very popular program, and the voters of California have no reason not to vote authorization for new bond sales each time it comes around, and they have done so.

Miss KAPTUR. I have always been interested in housing programs that work in conjunction with State governments and State authorities.

Mr. RHOADES. I might add, Madam Chairwoman, as I recall, around 1984 there was some legislation which went through Congress to restrict the capability of States to issue these bonds, but exemptions were made for States that had existing veterans' home loan bond programs. I don't know the status of that. Do you, Dick?

Mr. JOHNSON. Well, I am not really sure I remember all of it, but let me just kind of pour off at the mouth here for a minute on what I do remember.

It was part of tax reform in 1986, and the idea behind it was that States were hiding a lot of their revenues in public bonds which were not taxed at the Federal level, so those programs that were in existence, State mortgage bond programs, veterans' housing programs that were in existence, and some other similar types of programs for public housing and so forth, were preserved under the old tax rules of being tax exempt from State and Federal level, or at least from Federal level under tax reform in 1986, but no State can now enter into a new program unless they are willing to pay the Federal tax on it.

Miss KAPTUR. I know just since I have been in Congress the last 5 or 6 years, we have constantly had struggles—I am on the other housing committee over in Banking, also—to extend the revenue bond programs, both the industrial revenue bond and the mortgage revenue bond programs, so you are correct in stating it is a struggle within the Ways and Means Committee, but I appreciate your bringing the State programs to our attention. It is something I think we should at least think about as we look at options and what the revenue impact is at the Federal level. I think it is a good thought, worthy of having its own parallel track.

Dr. Rowland, did you have some questions of the witnesses, please?

Dr. ROWLAND OF GEORGIA. Yes, I have a couple. Thank you, Madam Chairwoman.

In reading, looking at the development of this mortgage indemnity fund—and the words "trust fund" were used there—it is really distressing to realize that there is—of course there is not any money to invest now—but there never was any investment of monies for some return, some interest. I think we have to be very careful that this money that accumulates is not available to OMB to be subject to Gramm-Rudman for purposes of deficit reduction.

As a matter of fact, that is one of the problems, I think, that we have now. We have so many trust funds that are used for that, like the Airport and Airways and the Highway Trust Fund, and it just is—our budget deficit is much worse than it looks like. It really is, and so there needs to be in my opinion some protection, that that money cannot be subject to Gramm-Rudman for the purpose of deficit reduction. I think that is what you were saying and I think that is very important.

Let me ask something about those veterans who are drawing disability compensation now. I was going to ask the question about how many veterans that was, but I believe you said about 6 percent of the veterans now. Do we know how much that is in money? Does anybody have an idea about how much that is in terms of money, what that amounts to?

Mr. JOHNSON. Are we talking about the total amount of compensation?

Dr. ROWLAND OF GEORGIA. No, the amount of veterans that are participating in the guaranty fund for homes, and about how much money are we talking about.

Mr. JOHNSON. Revenue lost, fee revenue lost to disabled veterans?

Dr. ROWLAND OF GEORGIA. Well, I am not really talking about revenue lost. I am talking about how much money that would be going into this fund. I think someone raised the point there about they didn't know how much that would affect the fund, if they were exempt.

Mr. **Edmiston**. Well, Dr. Rowland, I think that hinges on the amount of the loan.

Dr. **Rowland of Georgia**. That's right.

Mr. **Edmiston**. So I really don't know if there is an average loan amount that that could be equated to, but it seems to me that in each of the last few years there have been around 200,000 or 225,000 loans approved by the VA, and so 6 percent of that would probably be close the number of participants who are service-connected disabled veterans. But in terms of the financial impact of deleting that fee, I really don't have that number.

Dr. **Rowland of Georgia**. That was really my question, you know.

Miss **Kaptur**. Dr. Rowland, I was just given a figure by the staff here which is a real ball park figure. If the CBO estimate is correct, and we stop collecting the 1 percent fee, the first year we would lose something like $200 million. You then take 6 percent of that, I mean just average 6 percent service-connected. That comes out to about $12 million, real rough.

Dr. **Rowland of Georgia**. Yes. I guess that is only a ball park figure.

Miss **Kaptur**. We will have to take a look at that.

Dr. **Rowland of Georgia**. I wondered just how much that would be. You wanted to make a comment?

Mr. **Rhoades**. No, no. I think that is a novel way of answering the question, without having to go through a lot of math I was going to suggest.

Dr. **Rowland of Georgia**. Let me ask one other question relative to that, about exempting veterans who draw compensation from this. Would you in any way means-test that, or would that just be a blanket—you know, there are some veterans that are really, really disabled, and others that are not disabled as much, and then there is a means test from the standpoint of how financially well off they are, too. I wonder if there was any thought given to that, or just a blanket test?

Mr. **Edmiston**. Well, Dr. Rowland, we don't believe means testing should come into play in any service-connected program. Our view is that they should be exempted completely, without regard to whether that is a zero percent service-connected disability or a 100 percent disability.

Dr. **Rowland of Georgia**. I see.

Mr. **Bollinger**. If I may, it doesn't sound to me like we are talking about enough money that it would have a bearing on the success or failure of the program. That being the case, I think a decision would just have to simply be made whether to exempt them or to include them. I don't think there would have to be a means test.

Dr. **Rowland of Georgia**. I see.

Mr. **Rhoades**. I don't know if the administrative cost would justify means testing, aside from the fact that I really don't believe that in the case of service-connected disabled veterans, there ought to be a means test to an entitlement.

Mr. **Johnson**. In any sense, we concur in that also. We would not means test any portion of the program.

Mr. **Cullinan**. The VFW, as well, wouldn't want to see a means test.

Dr. **Rowland of Georgia**. Well, you are all together on that, aren't you? Thank you. Thank you very much.

Thank you, Madam Chairwoman.

Miss **Kaptur**. Thank you, Dr. Rowland.

I wanted to just ask a philosophical question here of Mr. Cullinan or anyone who wishes to respond, and that is, in thinking about the fairness of the indemnity program we are talking about, is it more equitable to require veterans to pay a funding fee currently which is used to offset costs of previous loans, or is it more fair to use the fee to offset costs that are associated with the veteran's own loan?

Mr. **Johnson**. May I address that?

Miss **Kaptur**. We have several people. We will start with Mr. Cullinan and we will move through.

Mr. **Johnson**. Let's go from left to right.

Mr. **Cullinan**. Yes. I think it is pretty clearly indicated in our statement that we support a veteran having to support the cost of his own loan, as opposed to having to sustain past deficits which we recognize as being OMB-precipitated.

I would like to add something to that, too, along the line of equity. It was mentioned earlier that in a sense it would be unfair to those veterans who don't go into default on their loans, to charge them this extra quarter percent, or to impose a 1.25 percent fee, however you want to phrase that. We would disagree with that. Finally, an indemnity program is of course, akin to insurance, and most people happily buy insurance hoping to never collect on it. We view the indemnity fund as being a similar situation. In other words, they get peace of mind for their investment.

Mr. **Rhoades**. The 1 percent user fee, for one thing, is payment for the sins of the father, essentially, by the son. The American Legion has always viewed it as a tax. The 1.25 percent fee for indemnity we like because it is really buying insurance, as my friend from the VFW indicated. We also like the feature of the legislation which has the Government making a quarter percent contribution over 3 years. That way, the Government is sharing in the cost of the insurance.

Mr. **Johnson**. As we stated earlier, we don't much care for fees, and we certainly don't much care for the dialogue that we are having right now where we are looking at permanent fees in a program. The program was previously operated without fees. There is no reason we can't go back to that.

Secondly, it is kind of a smoke-and-mirrors game that we are playing here when we talk about who is paying for what and how much. There is no particular romance, as far as I understand it, and certainly not in the CBO numbers that I have seen, in a 1.25 percent fee versus a 1 percent fee for mortgage indemnity insurance, or even a quarter percent per year contribution on behalf of Government as opposed to a .3 percent contribution per year on behalf of Government.

There is no romance in these numbers. There is no actual relationship to the kind of mortgage indemnity that we are selling the veteran, just as there was no relationship, other than the Federal need for money to support the program, in creating the 1 percent fee, so going from 1 percent to 1.25 percent to me just—we can justify it, if we want to kid ourselves into believing that we are selling somebody something for that additional quarter percent. We can do that, but we are not, really. That number came out of thin air somewhere, just for the purpose of discussion, and it has been hung on the program.

I don't see why we have to increase the fee to 1.25 percent, quite frankly, Madam Chairwoman. CBO numbers certainly don't suggest that we should, and I don't think we need to kid anybody into believing that we need to.

Miss KAPTUR. CBO numbers do not indicate that we should, did you say?

Mr. JOHNSON. The CBO numbers indicate that there is going to be a surplus in this program almost immediately. Almost immediately there will be a surplus in mortgage indemnity. They also indicate that after 3 years, as the lady from CBO testified this morning, if my notes are correct. You are going to have a surplus in the loan guaranty program in 3 years; you are going to have a surplus in the mortgage indemnity program almost immediately.

Now that to me doesn't suggest that we need to increase fees charged to veterans by a quarter of a percent, and it doesn't suggest to me that the veterans should have to pay more in a contribution than Government should. The reason we are going through these drills is because Government failed in its responsibility to maintain the program.

Miss KAPTUR. Well, I think that you raise a very good point. The committee is very sensitive to the numbers, and we are asking not only CBO's help but several other number crunchers around town to help us run the numbers, so we make sure that we aren't trying to squeeze blood out of a stone here. The draft proposal is just that, a draft proposal, and we are going to be very conservative in what we ultimately arrive at here.

Mr. JOHNSON. I understand that, Madam Chairwoman, and I hope I haven't offended the committee in my presentation, but I do—

Miss KAPTUR. Well, when you said "the Government," we in the legislative branch are very sensitive. We feel we have saved this program. We tire more of OMB than maybe you do. We are a bit sensitive on that point.

Mr. JOHNSON. We appreciate that, and the chairwoman has my apology.

Miss KAPTUR. I will say this, however: We do go to bed at night and dream about $2 billion holes in the fund, and believing this is an entitlement, how we are going to maintain it. We just can't ride on the laurels of the past and the successes of the past. We have to be very creative. Our primary mission is to serve the veteran and to make sure that this program is there, so we know that that is our mission. We would welcome your help as we try to meet the realities of the budget test here and do what is fair to the veteran and to the preservation of this program.

Mr. **Edmiston**. I would just add to the previous comments that it is—and I think you just touched on what I was going to say—that is, that the past mistakes have brought us here today. While we don't like to see any kind of fee for any veteran, whether they are disabled or not, we intend to work closely with the subcommittee to attempt to find a way to be creative and to make it better for the future, so that we don't have to go through this sort of exercise again.

Miss **Kaptur**. You know, Mr. Edmiston, the budgeteers told us—and I am not on the Budget Committee—that we would reap the costs of what was done in the early 1980's across the Government on the sale of assets and so forth, and now we see it here in the VA program. I almost have no doubt, though I haven't looked at the numbers, that Farmers' Home and FHA and any other agency that has assets are probably facing the same, the very same problem.

Mr. Bollinger, did you have a final—

Mr. **Bollinger**. In answer to your question, Madam Chairwoman, as I said, PVA has historically opposed the user fee but now, given this draft legislation, we can certainly endorse the 1.25 percent indemnity fee. I emphasize again, we are all here today to save a program. That being the case, I think we have to look very seriously at changing some aspects of the program that we have been very comfortable with in the past, but in the long run could very well save the program.

Miss **Kaptur**. Thank you very much. I appreciate the amount of time that you have given us this morning, and I just want to say to each of you, because we have seen you before on many issues, your respective organizations should be very proud of you because I think you do a fine job, and this is not an easy area, this housing—very complicated. After 20 years in the field, I am still trying to understand everything, the definitions and the numbers, so I can imagine how others must feel. I greatly appreciate the time that you are giving. This is not an easy one, so we appreciate the time that you are devoting to it. We really need you on this one.

Mr. **Johnson**. Thank you.

Mr. **Edmiston**. Thank you very much.

Mr. **Rhoades**. Thank you.

Mr. **Cullinan**. Thank you.

Mr. **Bollinger**. Thank you.

Miss **Kaptur**. We know that we have gone over this morning, and in order to try to be fair to all the panelists and the time constraints on the forthcoming witnesses, I would ask the staff's help in adding a couple more chairs up there, and I am going to call both panels together and to call on Mr. Evans first, because of a plane problem. If there is anyone else that has a time constraint, please let us know.

I would like to call up Mr. Robert O'Toole, Mortgage Bankers Association of America; Mr. Martin Perlman, the vice president and treasurer of the National Association of Home Builders; Mr. Robert Edelstein, professor of business administration, University of California, Berkeley—Mr. Bob Muffley from the National Association of Realtors; Mr. Ronald Evans with the National Auctioneers Association; Mr. Larry Latham from Larry Latham Auctioneers; and

Mr. Jerry Conners from the Manufactured Housing Institute, who is accompanied by Mr. Joe Owens.

Now I know it is going to be a little bit crowded up there, but do any of you gentlemen have a time constraint, other than Mr. Evans?

[No response.]

Miss KAPTUR. All right. I appreciate the perseverance of the remaining panelists. I want you to feel at home here, and not sit out there in audience.

If it is all right with you, I would begin with Mr. Evans, since we know that he has to leave. There you are. Okay, Mr. Evans. We would call upon you first, sir.

STATEMENT OF W. RONALD EVANS, MEMBER OF THE NATIONAL AUCTIONEERS ASSOCIATION

Mr. EVANS. Madam Chairwoman, members of the committee, my name is W. Ronald Evans, a certified auctioneer and the president and chief executive officer of the Capital City Enterprises, trading as Capital City Auctioneers and Capital City Realty here in Washington, D.C. I have included in my formal testimony a copy of my biographical sketch and a history of my business, for your information and the record.

Miss KAPTUR. Thank you.

Mr. EVANS. I am representing the National Auctioneers Association today, and I bring greetings from the national president, Haskel Ayers, the board of directors, Harvey L. McCray, executive vice president, and the staff of the National Auctioneers Association in Overland Park, Kansas.

It is with great pleasure that I present testimony today on the matter before this subcommittee, regarding the use of the auction method of disposing of surplus properties owned by the Federal Government or, more specifically, those properties owned by the Veterans' Administration. The National Auctioneers Association, an organization of over 6,000 members in the United States, Canada, and other countries, its affiliate, the Certified Auctioneers Educational Institute, and the National Auctioneers License Law Officials, these associations are constantly educating the consumer on the auction method and how to buy at auction.

Let me begin by stating this country is governed by activities of the auction method. The Department of Treasury sells Treasury notes at auction. Wall Street is run by the auction method. Livestock, tobacco, and other commodities are sold at auction every day. The sale of real estate at auction is not new, as a matter of fact. According to our first historian, Heroditus, the first auctions were held in Babylon around 500 B.C. Today the auction method of marketing is recognized as the most convenient, efficient, quickest and surest system to sell real and personal property in America.

As auctioneers, we bring qualified buyers to the table to achieve the highest price possible at the time of the auction. The auction method of marketing real estate uses the ascending monetary scale while marketing real estate at private treaty and the general brokerage method uses the descending scale. Using the auction method, we start at an opening price and slowly increase to a maximum, rather than start at maximum and move down to a price until you find a buyer.

I will not try to address my comments to the entire agenda of this committee today, but I will restrict my comments to the question of auction, a separate and distinct question of its own. Auctions are not necessarily a part of the problem. May I state that at no time has there been any analysis of the use of the auction method over the private treaty method. As a matter of fact, the use of the private treaty method, or lack of it, is the reason the auction method has been employed to assist the Veterans' Administration in lowering its inventory of Government-owned properties.

We, the auctioneers, respectfully request that the Congress, this committee and/or subcommittee, hold hearings on this issue singularly before a determination is made on the removal of the method used in disposition of said properties. The maintenance, rehabilitation, and the cost of security of those properties could make the properties unmarketable at current market prices.

For example, most houses in the program have deteriorated so badly, major renovations are necessary to make them marketable to the general public. I use as an example in yesterday's paper only to show you that some 45 properties were listed in the Washington Post, veteran-owned properties to be sold by brokers like myself, also, and I use one particular property specifically, 1352 Franklin Street here in Washington, D.C. The house is listed at $56,000. No one will pay more than $20,000 for that house in its condition, so it attracts only speculators and investors.

The auction method allows the Government to market them on the day of sale to a number of potential purchasers, many times with prior approved credit and the understanding that the renovations are necessary before permanent financing can be placed on it. Additionally, the marketing method of auctioning does not exclude other real estate personnel from participating in the auction with the auctioneer. Most auctioneers encourage real estate professionals to assist their clients, with a cooperating commission.

There is no evidence under Chapter 1337 of Title 38, United States Code, that there is any damage from the use of the auction method. Higher prices have been obtained through the conventional private treaty method. As a matter of fact, many of the properties have been on the market for extended periods of time prior to use of the auction method. There is no evidence that the auction method has a detrimental effect on local economy and property values, and the auction method does not result in the lowest price received for the property. We have many examples of the opposite being the rule.

Again, there is no evidence that the purchasers planning to purchase a new home are prevented from purchasing when properties are chosen by this method. Instead, we the auctioneers encourage real estate professionals to participate in our sales, and invite them to participate in the commissions by requiring them to register and accompany their clients to the auction. Additionally, extensive advertising and public relations activities take place to inform the public of upcoming auctions.

I had a few quotes that I wanted to give to you from a letter that was addressed to you, Madam Chairwoman. I understand my time is up, but I would be able to answer any questions and present them for the record. On behalf of the National Auctioneers Association, we want to thank you for the opportunity of testifying today, and I would be happy to answer any questions.

[The prepared statement of Mr. Evans appears on p. 110.]

Miss KAPTUR. Thank you, Mr. Evans, very much, and for staying within the time limit.

May I ask you, have you personally ever auctioned any Government properties?

Mr. EVANS. I have worked with two of the largest auction firms in the country in working with the auction process, in Gary, Indiana, Denver, Colorado, and Florida.

Miss KAPTUR. In being involved in those sales, did you see any difference between the operation of those auctions versus those held by the private sector?

Mr. EVANS. Not particularly, not with volume. Generally there are more than 100 houses at a time.

Miss KAPTUR. All right. If you were to personally auction some of the Veterans' Administration properties, how would you envision the handling of this procedure?

Mr. EVANS. Generally in a ballroom type setting, as we do presently, and I think that if we had the opportunity prior to the extended period of time to sell them, I would be willing to say that we would in fact get higher prices than those that have been set for them as the minimums.

Miss KAPTUR. This is a difficult question to ask you because you are on the private side, but in trying to do that, how would you ensure the Government's interests? You have obviously sat here this morning and heard the testimony about some of the shortfalls in some of our funds, and you as an American citizen know the Federal deficit and what that is like, so we would like to get the highest return on our dollar if these assets are going to be sold. We have heard that the average is maybe 40 cents on a dollar that the Government gets back in many cases.

I see someone out there in the audience from Houston, Texas, where this committee visited, where literally 25 percent of the foreclosed properties in our portfolio exist, and auctions have just created a horrible situation there in further depressing property values and creating havoc in the real estate market. How in the world, from what you know of the auction world, would you ensure the best interests of the United States Government in going about this process?

Mr. EVANS. Well, Madam Chairwoman, we know that at the day of auction we would get the highest possible price on the market on that particular day. We cannot control what is going on in any particular economy in a given area but overall, throughout the country, the auctions that I have attended, we have found that the prices exceed the minimums that have been required, within the range. With Houston being a very unusual area, with the oil glut and what not, that has created a problem there. I would think that if you went to other communities and tried it, we would certainly come up with higher figures than those that have been presented.

Miss KAPTUR. Now when you said minimum range—

Mr. **Evans**. Generally the Government gives us a minimum that we have to work within, and they will either accept or reject whatever the bid is at that point in time, so we have had sales where the Government has actually rejected a bid that was received and put it back on the block at a later time, within the period of an auction.

Miss **Kaptur**. Do any of the counsels have any question?

[No response.]

Miss **Kaptur**. Very good. Mr. Evans, we thank you very much. This auction issue has been an extremely controversial one, and I think you are an excellent representative of your industry. We look forward to working with you. The auction issue is one that this committee is still reviewing.

Mr. **Evans**. Thank you very much for allowing me to come, and thank you for letting me come on early.

Miss **Kaptur**. That's all right, and I thank the other panelists for that courtesy, as well.

We will now proceed in order, and call on Mr. Robert O'Toole from the Mortgage Bankers Association of America to present their testimony. Welcome back, Mr. O'Toole.

STATEMENT OF ROBERT M. O'TOOLE, STAFF VICE PRESIDENT, RESIDENTIAL FINANCE AND GOVERNMENT AGENCY RELATIONS, MORTGAGE BANKERS ASSOCIATION OF AMERICA

Mr. **O'Toole**. As usual, Madam Chairwoman, MBA appreciates the opportunity to testify. We are going to testify this morning on proposals to create a mortgage indemnity fund for new loans, as well as the shared equity proposal of Professor Edelstein, and we wish to express our continuing concern about the long-term solvency of the Loan Guaranty Fund.

Currently, the risks associated with loan foreclosures are shared by the veteran by paying the 1 percent funding fee, by the mortgage lender by the losses sustained on no-bids, and by the Federal Government by substantial appropriations. The draft proposal creating an indemnity fund for future loans would put a larger burden on the veteran borrower by increasing and making permanent the funding fee, and on the Federal Government by appropriating monies for all loans when they originate. The proposal also leaves in place the current no-bid provisions, so lenders will continue to share in the risk burden.

This proposal is very similar to the administration's proposals for so-called credit reform, which could subject the VA program to a variety of Gramm-Rudman-Hollings budget procedures. Presumably the VA will estimate the dollar amount of loans to be originated and request an appropriation for the Government's three-quarter percent premium based on that amount. If the projection is too low, we anticipate that there could be a halt in the program.

MBA has always opposed such credit legislation because it could arbitrarily prevent veterans who applied late in the fiscal year from receiving a loan. The proposal represents a step away from a true entitlement program toward the administration's philosophy of attempting to place a value on the Federal guaranty. In addition, the proposal appears to reverse action taken last year by the

Congress to exempt the VA loan guaranty program from Gramm-Rudman-Hollings sequestration.

If Federal deficit levels exceed certain targets, the funding for the program would be reduced and the number of loans originated would be reduced. Consequently, as in the case where projections are too low, eligible veterans entitled to the guaranty would not be able to obtain a VA-guaranteed loan.

The indemnity fund proposal does not address the financial problems facing the revolving fund. By removing the current 1 percent funding fee, the revolving fund could be even more dependent upon appropriations. These increased appropriations and the proposed new indemnity fund appropriation would make the VA home loan program appear more costly at a time when budget considerations are extremely sensitive.

A serious problem, costing the Government as well as the lender a great deal of needless expense, is the lack of adequate VA personnel to administer the home loan program. The expense of additional trained personnel would be far more than offset by the savings realized in prompt and efficient processing of claims and property disposition. MBA reiterates that efficiencies in program management, including adequate staffing and equipment, plus sound financial decisions with a long-term perspective, could not help but improve the financial position of the revolving fund.

MBA would like to offer its comments on the shared equity concept proposed by Professor Edelstein. The proposal assumes that there will be a future transaction that will measure whether the veteran has increased the equity in the home. This may not happen for many years, if at all. Another issue is what legal mechanism the VA would have available in order to enforce its rights to a fee.

MBA believes that the proposal to sell VA loans with or without recourse, as long as at least 90 percent of the loan value is received, is reasonable, but is concerned that this percentage could be reduced in the future.

Finally, MBA supports the sense of Congress proposal concerning the disposal of VA-acquired properties by auction. MBA agrees that such practices have negative effects on the loan guaranty program and on local economic conditions and property values, and that disposals of property by the VA should be done by a more orderly method that preserves property values.

MBA appreciates the opportunity to testify, and I will be happy to answer any questions.

[The prepared statement of Mr. O'Toole appears on p. 116.]

Miss **Kaptur**. All right. That was just excellent testimony. Thank you so very much.

Mr. Perlman?

STATEMENT OF MARTIN PERLMAN, VICE PRESIDENT AND TREASURER, NATIONAL ASSOCIATION OF HOME BUILDERS

Mr. **Perlman**. Thank you, Madam Chairwoman. I am pleased to be here this afternoon, representing NAHB's 150,000 members as its vice president and treasurer. I feel I am at home again because, as you know, I have testified before this subcommittee several times during the past year. I was also honored to attend the closing of the 12 millionth VA loan in Phoenix, representing the National Association of Home Builders about a year ago.

Madam Chairwoman, you have asked us to explore alternative methods of funding the VA Home Loan Guaranty Program to try to make it self-sustaining. Leading these possibilities are proposals to restructure the current benefit program to a loan indemnification program, and a shared equity plan.

We feel, however, that starting with the premise that the VA program must either be self-sufficient or solvent goes against the concept of an entitlement program. A veteran is entitled to the benefit of the VA Home Loan Guaranty Program because, as they say on TV, "he has earned it." If the program suffers losses because of economic declines which cause defaults or falling real estate values or high interest rates, then Congress should appropriate the funds necessary to cover these losses.

We are pleased that Congress appropriated the required funds in fiscal year 1988, and hopefully you will provide adequate appropriations in fiscal year 1989 as well. The first signs of recovery in economically distressed areas are starting to show, and this should require smaller appropriations in the future or, hopefully, no appropriations at all. Let me say in my home town of Houston, Texas we are starting to see the first signs of recovery. Job formation is up. Unemployment is down. Postings for foreclosures are down, and rentals for housing are firming.

To confront the problems surrounding the program, we recommend the establishment of an independent commission to address the solvency issues. Authority to establish a commission was passed by the Senate in April. Recommendations from reports recently commissioned by the VA will also be of help in evaluating changes and needs of the program. We urge the subcommittee to evaluate these options before proceeding with major program changes.

Regarding the subcommittee's specific requests, we are concerned that the mortgage indemnification program and shared equity plan will fundamentally change the entitlement nature of the VA Home Loan Guaranty Program without achieving the required objective of making the program actuarially sound. While the loan indemnification proposal has the appearance of working, there are many drawbacks. The veteran would simply be substituting a 1 percent funding fee for a 1.25 percent indemnification fee. The indemnification fee paid by the veteran and the Government may be insufficient to over the losses in the program on new loans. In all likelihood, some initial capital infusion or additional appropriation may be necessary.

We feel the shared equity program is also flawed for the following reasons: One, even if there is a gain on the resale of the veteran's home, it is not necessarily a windfall gain. A veteran may have sold the home to purchase another home in the same area, which may also have risen in price, completely offsetting the gain made by the veteran on his initial home sale.

Two, the concept of tying the amount of equity sharing to the amount of downpayment is also flawed. There is no incentive for veterans to use the program if the downpayment still must be accompanied by a return of some equity gain on the resale. Veterans able to make downpayments would instead use the FHA or even conventional loans, rather than give up equity gains.

Three, it is a disincentive for a veteran who is trying to keep ahead of inflation, to know that he may not realize the full value of his property.

Madam Chairwoman, as I have testified before you in the past, we are adamantly opposed to auctions for selling foreclosed properties in distressed areas. We feel that the sense of Congress legislation in the committee print, which calls for renting properties with the option to buy, is a viable alternative. It is workable if the buyer would have to meet standard qualifications for purchase. It is even more viable if a portion of the rent is applied toward the reduction of the cost of the home.

Let me say that another major problem impacting the cost of the program is that the VA is allowing subdivisions of foreclosed properties to deteriorate. I would also like to point out that appraisal practices by some FHA and VA offices require appraisals to include foreclosed properties as comparables when evaluating the price of a home. Like auctions, these practices result in the loss of homeowners' equity, which leads to further foreclosures and added losses in the Government's housing portfolios.

Madam Chairwoman, we believe that the foreclosure problem should be addressed by keeping the veteran in his home in the first place. Solutions might include a short-term forbearance in the form of a moratorium or a reduction in interest rates for veterans who are in financial trouble. NAHB's board of directors passed policy supporting forbearance on FHA and VA home loans. They stressed that homeownership is a cornerstone of our American way of life, and that it is the biggest asset many families have. In most cases, through no personal fault of their own, many are unable to keep their mortgage payments current. I know that this is the case in many cities in oil patch areas like my home in Houston.

In conclusion, we hope that careful analysis will be given to retaining the entitlement nature of the VA Home Loan Guaranty Program, while trying to sustain it and make it self-sufficient.

Thank you for allowing us to present our views.

[The prepared statement of Mr. Perlman appears on p. 122.]

Miss KAPTUR. Thank you, Mr. Perlman, very much.

Mr. Edelstein, we did not have typed testimony.

Mr. EDELSTEIN. You don't, but I will provide some if you feel that it is useful.

Miss KAPTUR. All right. Thank you very much.

STATEMENT OF ROBERT H. EDELSTEIN, PROFESSOR OF BUSINESS ADMINISTRATION, UNIVERSITY OF CALIFORNIA, BERKELEY, AND CHAIR, REAL ESTATE FACULTY GROUP

Mr. EDELSTEIN. Madam Chairwoman and members of the committee, thank you for having me here.

From what I have heard, I think I have benefitted from some comments, and what I have heard suggests a fundamental misunderstanding of my proposal. I think that all of the objections that have surfaced can, quite frankly, easily be responded to without much difficulty. Maybe it is part of the nature of my career and business. This will be partially a lecture, and I apologize for the didactic approach, but there is a misunderstanding of the proposed "shared equity" loan plan.

First of all, this program is, de facto, a mortgage insurance function, and the problems that are being faced by the VA loan program are no different—maybe in magnitude they are different, and in particular details—but no different to what is happening out in the private sector and in other programs where basically you are serving a mortgage insurance function—mortgage insurance meaning insuring against default. The key risk, in the analysis of mortgage insurance or default insurance, is property market value risk.

Miss **Kaptur**. Excuse me. Is what?

Mr. **Edelstein**. Property market value risk. One of the things that sometimes seems to get put into the equation of evaluating risk is the credit-worthiness of the individual borrower. First of all, the credit-worthiness of the borrower is not independent of market value risk. If you go to places like Houston, the fundamental reason that property values declined was the economy. That means people who may have appeared to be credit-worthy at day one, sometime down the road lost their jobs, the value of their homes fell in half. When the borrower defaulted on his loan, the property value was insufficicient to repay the lender the outstanding loan balance.

The truth is that if the value of the property had risen while "the credit-worthiness of the borrower" had declined, that wouldn't be necessarily nice, but it would be no problem to the lender or mortgage insurer. In fact, you would not see that problem. What would happen? The borrower would sell the property himself, cash out. And if he defaulted, the institution and the ultimate guarantor, wouldn't worry either, if there were sufficient resources in the property value to protect against the loans that were at risk.

I think you can see this when someone mentioned the Cal-Vet Program, which has been very successful. The Cal-Vet Program is in California, where markets have been very robust over the long haul, and therefore the program has the underlying assets of the properties protecting the Cal-Vet Loan Program.

Now we come to the unfortunate problem: guessing where market values are going to go is the $64 question, and the $64 question is not easily answered. If we were here in the room—and I think I said this last time—in 1975, we would be looking at New York and saying how terrible things are in that real estate market, and Boston, and we would be looking at Houston, saying, "Isn't that a wonderful market?" We are here in 1988, and perhaps the reverse is true. These things are hard to forecast.

Given that nature, that different areas and different regions perform differently, the function and the conceptual solution must be one which, if you want the program to have internal solvency—which is an issue, of course—that in some way the people who have resources can pay off those who don't have resources. The bottom line is, someone has to pay. If you want to make this truly just a total entitlement program, then it is the taxpayer who will pay. I gather there is some objection to that, and I am not here to comment on that. If you want there to be an element of self-solvency, internal solvency, then let me suggest how the shared equity loan

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program can work and will work, and if you don't adopt it today, we will be back here maybe 20 years from today—suggesting something like it.

If we take a property that is purchased for $100,000—and we will talk just about the dynamics and the micro details—a $100,0[illegible] property purchased by a veteran, it appreciates to $130,000, n[illegible] after all selling costs. He sells it for $130,000. The $30,000 is net appreciation. It turns out you will need less than 2.5 percent of the net appreciation, which is 2.5 percent of $30,000 or $750, which is about half of a percent of the total market value, to make the program work.

This should be contrasted—and I know I am running out of time here—with the brokerage fees, which might be $6,500 on the same property. Now it is true you are taking "some equity," but this person has benefitted in a program where he has put nothing down. He didn't pay fees up front, which would have increased his monthly, which means he would have paid back the fee plus interest on the fee. He is paying this money afterwards. The shared equity loan program, under normal conditions over the long haul, should require a payment, based on a sharing rate of 2.5 to 5.0 percent of net equity, not more. I feel that we should separate the old program from the new program, and deal the old existing loans separately.

Let me just talk briefly about the worts that appear to have come up as part of the net shared equity plan. The administrative nightmare argument I find unfair and basically not true. When a property sells—

Miss **Kaptur**. Mr. Edelstein, why don't you just take an additional 2 minutes. That's all right.

Mr. **Edelstein**. Either that, or you should subdivide me and let me have two chances.

When a property sells there is typically a HUD I, RESPA statement, which is a real estate settlement statement for a sales transaction. Also, when a property sells, under Federal IRS tax law you have to fill out a form, if it is a principal residence, for the sale of principal residence, which will identify the net equity buildup. That is one piece of paper, not the whole tax return. We are asking for two pieces of paper, a RESPA HUD I and the sale of principal residence IRS form.

Also, administratively finding out if it happens, you can do it through tax records. You could have a lien on the property, for when it sells. Also, if it is a question of monitoring, I think it already should be VA's function, whether it does it or not, that they should know what current loan status. Is the property being refinanced? Has it been sold? Has it been transferred? This information is not an administrative burden, it is necessary information to run the VA program. If there is a nightmare, it is because there is a nightmare there already, not because of the two pieces of paper that would be required under my scheme.

Furthermore, it has been claimed that there may be adverse selection; that people may opt out of the program. The truth is that that just isn't the way it is going to work. The VA loans are very good deals, nothing down, and you can try this experimentally by

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having this program simultaneously, not independently of your other proposal, and see how people opt out. You can do both.

Also, there is some hidden thing in the indemnity fund proposal. As I calculated numbers, next year, in fiscal year 1988 and fiscal year 1989, there are $18 billion of loans that will be issued under the loan guaranty program. Under the three-quarters of a percent that eventually gets paid by the Government, if those numbers stay for 10 years, the taxpayers will have to contribute $1,350,000,000 to the new program. The program I am suggesting ultimately pays for itself, and requires nothing from the taxpayers.

I think there are differences, and I don't think, quite frankly, the proposal has been fully understood. In part it is my fault, the proposal wasn't fully developed, and I think in the materials I will send you, you will see a fuller development.

Thank you.

[The prepared statement of Mr. Edelstein appears on p. 144.]

Miss KAPTUR. Thank you, Mr. Edelstein. I, for one, would certainly be very interested, and would ask the Congressional Budget Office to help us cost out the near term and the long term costs to the Federal Government of these various options. I have to say, Mr. Edelstein, in spite of all the negative criticism your proposal has gotten—and I will probably alienate every single veteran in America—your proposal does interest me academically. It has a strong academic interest, so I would at least like to look at it a little more closely. Thank you for that.

Mr. Bob Muffley. Mr. Muffley, thank you for waiting. You have been great. If you could, just pull the microphone a little closer to yourself, please.

STATEMENT OF BOB J. MUFFLEY, CHAIRMAN, GOVERNMENT MORTGAGE PROGRAMS SUBCOMMITTEE, NATIONAL ASSOCIATION OF REALTORS

Mr. MUFFLEY. Thank you, Madam Chairwoman, members of the subcommittee. My name is Bob Muffley and I am a realtor from Gooding, Idaho, and this year's chairman of the Government Mortgage Programs Subcommittee of the National Association of Realtors. On behalf of the National Association of Realtors, I would like to thank you for inviting us to this hearing.

Our written statement details our specific comments and concerns with the provisions of the subcommittee's committee print and with other proposals before the subcommittee. For now, I would like to focus my oral comments on three specific areas: first, the concerns we have with replacing the VA Loan Guaranty Revolving Fund with a VA indemnity fund; second, why we oppose the shared equity appreciation program concept; and third, several suggestions for improving VA's property disposition efforts.

The indemnity fund. The National Association of Realtors appreciates the severe funding problems presently faced by the VA Home Loan Guaranty Program, and we understand that the purpose of the proposed indemnity fund is to revitalize the funding of the VA program while simultaneously to provide and increase financial protection for veterans in the event of default on a VA-guaranteed mortgage. The NAR supports each of these goals individually, and we strongly support efforts that strive for the goal that a veteran not lose his or her home.

We are concerned, however, that a likely side effect of the indemnity fund proposal may be to make default and foreclosure a more acceptable result for a veteran delinquent on his or her loan, as it appears to remove all personal liability. We believe that a key motivating factor for a home buyer to maintain his or her home purchase is the degree of personal liability for that loan. Thus, the removal of the personal liability for the mortgage loan may present an even greater risk to the VA program itself because it could result in a veteran's becoming more willing to abandon his or her property in the event of default.

We additionally oppose the indemnity fund's proposed increase of the amount of up-front fees that a veteran would be required to pay in order to obtain a VA-guaranteed mortgage. Although slight, the proposed indemnity fee of 1.25 percent of the loan amount represents an important increase over the 1 percent funding fee presently charged. We do not believe that the veterans should be charged increased fees in order to use their entitlement program.

The indemnity fund proposal, as envisioned, would be applied to and used for VA loans guaranteed after the effective date of the legislation, and the 1 percent funding fee presently being paid by veterans into the VA Loan Guaranty Revolving Fund would be discontinued. However, the Loan Guaranty Revolving Fund will be maintained in order to pay claims based on the loans that it has previously guaranteed. In the absence of its primary source of income, the National Association of Realtors is concerned that Congress will have to appropriate substantial amounts to the Loan Guaranty Revolving Fund just to keep it alive long enough to fulfill its present obligations. We respectfully request that the subcommittee evaluate the costs of transition from a loan guaranty revolving fund to an indemnity fund.

On the shared equity appreciation mortgage program concept, the essence of the shared equity program proposal that has been previously presented to this subcommittee is to entitle the VA to receive a portion of the appreciation of a veteran's home at the time that a home with a VA-guaranteed loan is sold. It is apparent that this proposal was intended to serve as a vehicle to provide increased revenue to the VA home loan guaranty fund. At first blush the proposal appears to achieve that goal. However, a closer view reveals several potential serious threats to the benefit of the homeowner for any veteran who elects this option.

First, although the proposal is envisioned as a complement to the standard VA program, it fails to provide any benefit to a veteran for participating in that program. Instead, the program establishes, in effect, a Federal tax upon the sale of a property with a VA-guaranteed mortgage.

Second, more significantly, the amount charged by such a tax would vary between cities and regions and would require VA homeowners in regions experiencing greater appreciation to pay more than the VA homeowners in the other regions.

Finally, the plan unfairly penalizes those veterans who increase the value and/or sales price of their home through the efforts of sweat equity, and may actually discourage such efforts.

The National Association of Realtors strongly urges the subcommittee to reject any such proposal to tax or otherwise draw upon the appreciation of a veteran's home.

As members of the subcommittee are aware, the National Association of Realtors is opposed to continued VA attempts to auction large numbers of its acquired properties. I would like to emphasize, however, that the solution to the VA's property disposition ills need not require the prohibition of this sales option, but rather should direct that action be utilized by the VA as part of a comprehensive and intelligent property disposition program. Members of our association are pleased to offer our assistance and expertise to this subcommittee and to the Veterans' Administration to develop an effective property disposition program that utilizes the many, many resources at its disposal.

For example, VA should, in—I'm sorry. I have run over my time limit.

Miss Kaptur. Go right ahead.

Mr. Muffley. Thank you.

VA should, in conjunction with the local real estate industry, develop a property disposition strategy that develops and utilizes innovative, market-oriented property disposition methods. VA should improve its property management responsibilities. An effective property disposition program requires effective property management techniques, either performed by VA or contracted by a property management professional to avoid damage that can result from a diminished sales price.

VA's property disposition program should be conducted on a regular basis. It should be unacceptable practice to accumulate large numbers of properties and then dump them when either the cost of management becomes unbearable or additional funding for the VA program is required. A properly timed, promoted, marketed and conducted real estate auction can be a useful mechanism to sell acquired properties. Such a plan should, however, discourage the sale of large numbers of properties on the same day, and should be scheduled to complement, not undermine, other local efforts to set up an effective property disposition program.

Finally, Madam Chairwoman, you will recall that when I testified before this subcommittee in March, I indicated that our association was planning to conduct its own evaluation of the VA program. Last month I chaired a study group to do just that, and I would like to call your attention to pages 8 through 12 of our written statement which details our association's specific recommendations concerning the staffing of the VA regional offices, the rental of VA-acquired properties, methods for veterans and VA to avoid lengthy and costly foreclosure proceedings, additional recommendations for the disposition of acquired properties, and suggestions for improving the solvency of the loan guaranty fund, such as revitalizing the direct loan program and exempting VA from the executive order directive that required Federal agencies to dispose of their assets.

Thank you, Madam Chairwoman. I would be glad to answer any questions.

[The prepared statement of Mr. Muffley appears on p. 155.]

Miss Kaptur. Thank you very much.

Mr. Latham?

STATEMENT OF LARRY W. LATHAM, CHIEF EXECUTIVE OFFICER AND PRESIDENT, LARRY LATHAM AUCTIONEERS

Mr. LATHAM. Yes, ma'am. I would like to thank you, Madam Chairwoman, for allowing me to testify before the subcommittee today. I am chief executive officer of Larry Latham Auctioneers, a firm which auctions the largest number of single family homes annually in the United States. I am also a real estate broker in several States. I have previously been a home builder, and in fact constructed Veterans' Administration homes in my home area of northern Alabama prior to entering the auction business in the late 1970's.

Through a nationwide competitive bidding process, my company was awarded and now holds the auction contract for the Veterans' Administration. In addition to doing VA properties at auction, my firm also markets for sale HUD properties, Fannie Mae properties, Farmers' Home Administration properties, also for large S&L's mortgage companies and banks. Because of the comprehensive background with the Veterans' Administration and its housing problems, as well as my experience with the effectiveness of the auction sales tool for disposing of Government-owned real estate, I am regarded by many as the leading authority on Government auctions.

Let me say at the outset that I am very supportive of any methods that are designed to prevent the necessity for a foreclosure process, and I applaud you for tackling this problem with your proposed legislation. However, I would like to dispel the findings of Congress on the policy of using auctions for disposing of foreclosed real estate.

I think you will agree that Americans are the most competitive people in the world, and auctions do create urgency and competition. The auction method of real estate sales is one of the best ways to reach the buying public in a cost-effective manner. It offers sales flexibility, strong buyer attraction and a positive sales environment. Auction marketing can reach even hard-to-reach targeted buyers, and it brings those buyers to the market.

The congressional findings section alleges that the long-term interests of the housing loan guaranty program are damaged by the use of auctions, since a higher price could be obtained for real property by selling it through conventional methods. I believe that statement to be erroneous. To summarize the facts, the longer a property stays on the market, the more vandalism occurs to that property. Therefore, the final sales price decreases.

Conventional sales methods are not working. This is a proven fact, that the inventories of the VA and other Government agencies are growing, not decreasing, despite record numbers of conventional sales, and in many parts of the country the real estate market has not bottomed out yet. Therefore, holding houses costs the taxpayers and the consumers of this country vast amounts of money.

Many of the good properties that do go to auction bring tremendous prices, as an analysis of one of the Illinois auctions that we just finished will prove. We sold 305 out of 327 properties, for a sales rate of 93.2 percent. One of those properties brought over 500 percent of the list price. One of those properties brought over 300 percent of the list price. Twelve properties sold for 150 percent or over of the list price. Forty-eight properties sold for over 100 percent of the list price. These are prices that you would not have gotten on the conventional sales method. The overall sales percentage for that particular auction was 77.8 percent of the list price for all 305 properties.

The auction method of marketing properties gives a true market value. Some properties sell for well above 100 percent of their list prices. Others do sell for much less, but these latter properties are usually those that have been on the market for quite a long period of time, sometimes as long as 1 to 2 years, and most of those properties that bring low prices have been vandalized or are in certain sections of town that the properties have not been even shown in over a year.

The VA auctions often attract thousands of people, and these are the potential buyers for the very properties that the VA has not been able to sell otherwise.

In your discussion draft with respect to the loan program, it also contends that potential purchasers who have been planning to acquire such properties for use as homes are prevented from purchasing them when the properties are selected for auction with little or no publicity beforehand. Our experience in the past shows that less than 1 percent of those properties which the VA pulls for its auctions has or would have had a contract on them prior to pulling that particular property for auction.

"The auction method of marketing has become the fastest-growing segment of the real estate industry," says Steven Martin, president of the Gwent Group, an Indiana-based auction consulting firm, and last year more than $25 billion in real estate exchanged hands at auction, according to a study by the nonprofit Certified Auctioneers Institute at Indiana University.

I do not believe that Congress should help any special interest groups limit free enterprise, or put the burden of keeping these properties in inventory on the taxpayers. I believe that the Veterans' Administration, the regional directors, are in day-to-day contact with the realtors and understand their markets, and they should be able to continue to sell properties using every available means to decrease their inventories.

In conclusion, I hope that I have cleared up many of the erroneous pieces of information presented to you earlier, and I hope that you can feel the frustration of the National Auctioneers Association and myself on the way that auctions have been portrayed. All methods of sales should be utilized, especially those considered quick and fair. If many of the properties now in Government inventories were sold at auction, the ongoing burden to the taxpayer could be lifted and the heavy work load of Government agencies could be made manageable.

I would like to thank you for allowing me to present my testimony before the Subcommittee on Housing and Memorial Affairs today, and I will be happy to furnish any additional materials or information upon your request. Thank you, Madam Chairwoman.

[The prepared statement of Mr. Latham appears on p. 165.]

Miss KAPTUR. Thank you very much, Mr. Latham.

Finally we wanted to call on Mr. Jerry Conners. Will you be comfortable there, or do you want to go to the other side of the table?

Mr. CONNERS. No, I'm fine.

Miss KAPTUR. You're fine. All right. From the Manufactured Housing Institute, accompanied by Mr. Joe Owens.

STATEMENT OF JERRY C. CONNERS, PRESIDENT, MANUFACTURED HOUSING INSTITUTE, ACCOMPANIED BY JOE OWENS, VICE PRESIDENT-FINANCE

Mr. CONNERS. Thank you very much, Madam Chairwoman. I am very happy to be here this morning.

The Manufactured Housing Institute is a national trade association representing manufactured home builders and related suppliers of goods and services to the industry and its consumers. Of the top 25 producers of manufactured homes in 1986, 18 were members of MHI. MHI manufacturer members produce over half of the manufactured homes built in the United States.

The advantages of mass production spawned the development of factory-built housing over 50 years ago. Today there are several forms of factory-built homes, including modular, panelized and manufactured homes. Our remarks concern themselves with the form of factory-built housing known as manufactured homes, formerly known as mobile homes.

Since the beginning of the decade through the end of the first quarter of 1988, manufactured home builders have produced 2.139 million homes, accounting for 14.8 percent of the 14.497 million privately owned housing constructions started during the decade. The 1983 annual housing survey, the most recent of the annual housing surveys published by the Department of Commerce, indicates that there were 88.6 million full-time manufactured housing units at the end of 1983, including manufactured homes. Full-time occupied manufactured homes accounted for 4.7 million or 5.6 percent of the total occupied housing units in the U.S. at the end of 1983, according to the survey and MHI estimates.

The Veterans' Administration was first authorized to guarantee loans on manufactured homes by the Veterans Housing Act of 1970. The program has provided more than 110,000 veterans the opportunity to own their own home since its inception through April, 1988. For this reason, we believe that the program is an important and valuable part of the overall benefits provided to veterans through the various activities carried out by the VA. Manufactured home loans guaranteed by the VA are eligible for pooling into Government National Mortgage Association mortgage-backed securities, so the VA program also provides an important access to loan funds available through institutional investors and others who buy Ginnie Mae securities.

We support the creation of an indemnity fund to protect the Veterans' Administration against losses from loan defaults. As drafted, it would appear that the 1.25 percent initial fee is less of a burden to the veteran than the current 1 percent funding fee, since the former is allowed to be financed with the loan. Hence, not only has the VA gained some extra protection from loan defaults, but the veteran has been aided additionally, as well.

We understand the trade-off between the increased fees and releasing the veteran from any liability for defaults on a loan. However, we wonder if such an arrangement might send the wrong message to veteran borrowers. In a sense, they may assume they have purchased insurance against a default and have every right to use that insurance. We believe that the veteran should continue to be held accountable for loan deficiencies leading to claims paid by the VA. Perhaps some allowance may be made for the indemnity fund fees, but to release the veteran altogether from the obligation on the loan may very well lead to increased defaults.

We would favor a shared equity program to the extent that it would keep the VA program solvent and ensure its continuation over the long term. However, we feel that it may not be well accepted among veterans. Shared equity programs have been used successfully in some low-income housing programs. The VA program is not necessarily a low-income housing program, although it does provide a much-needed benefit to many low-income veterans and active duty personnel.

We feel that a shared equity program would make the VA program unattractive to veterans with moderate or better incomes who are nevertheless entitled to the program's benefit because of their military service, and as a practical matter the problems facing the VA program today are from properties where the veteran had very little or even negative equity in the home because of economic conditions in the area.

To charge a moderate fee for the benefit, as has been proposed in the creation of an indemnity fund, seems quite reasonable if the cost is equal to all veterans. However, a shared equity program would create a situation where some veterans are subsidizing others. We are not sure that a majority of veterans would favor such a program.

We mentioned earlier that Ginnie Mae's secondary market program for manufactured home loans is the only organized secondary market for these loans, so it is important that changes made in the VA home loan program not render manufactured home loans ineligible for pooling under the Ginnie Mae guidelines. We would urge the subcommittee to take this into consideration as it deliberates on the various alternatives that may come before it.

A veteran who purchases a conventionally built home with a VA-guaranteed loan is not required by the VA to make a downpayment on that loan. A veteran purchasing a manufactured home with a VA-guaranteed loan must make a minimum 5 percent downpayment. We feel this discriminates against lower-income veterans who purchase manufactured homes. It seems incongruous that veterans purchasing more expensive housing may do so with less cash than veterans purchasing manufactured housing. In light of the mortgage indemnity fund proposal, as well as the stricter underwriting guidelines implemented by the VA over a year ago, we think that the downpayment requirement for manufactured homes should be eliminated and that the program be put back on a parity basis with site-built housing.

We recently asked several people in the manufactured housing industry why the VA Home Loan Guaranty Program was not used to a greater extent. They felt that one important reason was the paperwork burden of using the program. We would urge the subcommittee to examine ways to reduce and simplify the paperwork required in the program.

Thank you, Madam Chairwoman.

[The prepared statement of Mr. Conners appears on p. 178.]

Miss Kaptur. Thank you very much, Mr. Conners, and thank you for waiting until the very end. You win the prize today. We will take your advice and no one else's.

[Laughter.]

I wanted to ask several questions, if I might here. Mr. Muffley, you in your testimony mentioned that we should try to work on enhancing the VA's direct loan program in areas where VA-guaranteed financing is not presently available. Do you have access to information on some of the areas in which this financing might not be available?

Mr. Muffley. The places we are talking about, Madam Chairwoman, are the small rural communities throughout this country that have no major lenders in them that would be using the VA guaranteed loans, of which there are numerous such areas.

Miss Kaptur. Well, you know, we would be interested in that type of information, because that is always the argument: When credit is readily available, why would you want to reinstitute a direct loan program?

Mr. Muffley. There is a lot of talk, Madam Chairwoman, about how far away does it become available. I think the mortgage bankers suggest 50 miles, if I am not mistaken.

Miss Kaptur. All right. Also, you state that the Veterans' Administration, in conjunction with the local real estate industry, could develop a property disposition strategy. Have you had a task force that was looking into this?

Mr. Muffley. Yes, Madam Chairwoman.

Miss Kaptur. What was the outcome of that task force?

Mr. Muffley. What we discovered was that every region, indeed many States, have their own particular problems and their own methods that they can best use to sell properties, so what we have suggested is that the regional offices of VA or the State offices of VA get together with the realtors in those particular areas and figure out the way to best market their properties in those areas.

Miss Kaptur. I wanted to just say, for this whole panel, I am hoping to get you embarked on a discussion here before we close today. I am going to pick on Mr. O'Toole first, because you know so much about the history of this program, but it seems to me that there are at least four options, four parallel tracks we could go down in thinking about the future of this program.

One is that we really basically accept the current program, and take the worst estimates of budget impact and appropriate money to the existing program to the tune of billions as we move into the 1990's. We might even, as a part of that, reinstitute a direct loan program in those areas of the country where there are credit shortages, if Mr. Muffley can help us identify those.

A second option might be the one that we are seriously looking at on this committee, which is the insurance option, the mortgage indemnity proposal, where we essentially stop the funding fee that goes to pay for the shortfalls in the fund presently, the indemnity proposal which would essentially be oriented toward the individual home buyer who would receive that indemnification, and the money would go to the individual, the protection would go to the individual borrower, VA borrower, rather than the money going into a fund that pays past losses, which is the existing system.

A third proposal is Professor Edelstein's controversial proposal on shared equity where he really says, the problem isn't the creditworthiness of the individual borrower, for the most part. The problem is when the economy hits the skids in whatever region of the country we are talking about, and we have really got to take a look at a better way of dealing with that risk and taking a look at a property-oriented—I can't remember the term he used—property market value risk system rather than one oriented toward the individual, which is what all of the systems to date have been oriented to.

Finally, we did have a somewhat undeveloped proposal from the Non Commissioned Officers on mortgage revenue bonds, some type of a proposal that we could look at that would enhance State efforts. We know we would get into the Ways and Means Committee jurisdiction here because we would have to get ceilings, but that is all right. We can think about that for a second.

I would like you, Mr. O'Toole, if you could, to discuss those, which seem to make the most sense. I recognize you have given your testimony and all the rest, but you may not have thought about it in just those terms before you came over here today. Which seem to make the most sense, from your long experience?

Mr. O'Toole. Well, I guess we have to have some decision on whether we are going to continue the program as an entitlement program. Anything beyond that, whether it is an insurance-based program—and I think if you are talking about an insurance-based program, you would have to look at a fee that is not arbitrarily determined, such as a quarter of 1 percent or 1.25 percent, but something that is based on the actual experience with the business that is being originated.

If the Congress is going to look at that, then we have to compare it with the FHA program. We have a program like that. It works extremely well, and the question would have to be asked at that point, if you are going to have the VA program and have a fee that is based on what the costs are to run that program, if it is necessary to continue the VA program the way we have historically?

Or is the Congress going to say that this program has had some difficulty in the past, some negative things have happened. The funding of the program was alluded to earlier. The direct loan program was eliminated, which was a revenue source. The VA was required to dispose of assets that it had, and income was coming in on those assets, and they were eliminated. But we are also seeing a turn-around in the default experience. Some tightening of underwriting took place two years ago, and just this past year there are parts of the country that are beginning to turn around. As Martin mentioned earlier, Houston looks like it might be coming around.

I guess the question is, is this going to be with us in the long term? Certainly it is a lot longer than those of us that were involved in it earlier. If you play out the insurance nature of some of the proposals, you get to the point that if the fee is going to be based on what the costs are, it is going to be very close to an FHA-type fee, then the question is, is it necessary to run two parallel programs? Or is this a program that the Congress and the American people have said we want to continue, we want it to be available, and we want to bear the costs of it?

Miss KAPTUR. Thank you very much.

You know, I wanted to ask Mr. Edelstein, is there some reason that—because of the credit-worthiness of the FHA program, why have you not been as favorable toward insurance programs? Why aren't you as supportive of those proposals as some of our witnesses have been? What is the reason for your significant departure from that line of thinking?

Mr. EDELSTEIN. First of all, I don't see this as necessarily an exclusive alternative to an insurance program, but the way the insurance, the indemnity fund type of program has been related to me, is that there are fees paid up front. Now either that means you are asking the veteran to pay the money directly, so you are in essence increasing the downpayment, or you are having him finance that. Now if you are giving him a 100 percent loan to start with, you are now giving him a 100 percent plus loan, and that increases the monthly burden which he then pays interest and principal on. He pays that all back.

Now that is an alternative but it is a form of attacking entitlement. That is really the fundamental issue. Do you want the loan program to be totally solvent, or partially solvent? Do you want it to be funded by something outside of the VA program? That is an issue I can't really address, but it is one of the things that comes up every time.

Obviously people have different ideas about what is fair, but if we wish to have program fiscal solvency, then there is a way to do that. You tighten credit standards. You increase fees, just as the private mortgage insurers do. Private mortgage insurers, when you go to the private sector, don't insure more than 95 percent, so you are now insuring 100 percent plus loans, which means you are higher risk still, which means the fees may not be high enough to adjust for the risk. In fact we are talking about 2 percent fees here, three-quarters paid by the Government and one and a quarter paid by the vet.

My alternative says, and it is a perception of fairness, that I gave you a 100 percent loan. You had no equity. You made money in the program because we gave you a start.

Some claimed earlier today that the shared equity loan is going to reduce a person's equity at the end. That is true, but if a veteran has bought a home and has gone from no equity to $30,000 less $750, you know, I think that he is still substantially better off. While it is true that market value has probably gone up in his neighborhood, the veteran is in a much better position to buy a bigger house. He has a downpayment that has been accrued through the market without him having to risk any of his own capital.

I think at the margin there will be people who find it less attractive to give up some part of their equity build-up. There was an argument that those who buy properties that experience the greatest appreciation will pay more to the VA. That is true, but people who take out larger loans pay more under your plan—right?—to buy more valuable houses, so that is symmetric, I think.

We are saying that people are lucky to be in a hot market, in a Boston where appreciation rates were 30 percent a year from 1980 to 1985. They are going to pay more into the program but they are far better off. They started with no equity and they have an enormous amount of equity at the time of sale. It is the advantage of leverage, so I would say this is an alternative, not necessarily the only alternative.

Miss Kaptur. You know, one of the interesting points you raise is, what is the true cost of any one of these proposals to the veteran. I am not sure who I could ask to prepare those charts for us, whether our CBO has the wherewithal to do it, or whether the Peat, Marwick study could do it for us. I see Keith Pedigo still sitting in the back there. When you talk about the true value of these programs, an interesting issue should be the present value of future benefits, and when you talk about the carrying cost over the life of the mortgage, I think the members of this committee would truly benefit in evaluating these various proposals if we had that information. I certainly don't have it now.

Mr. O'Toole, you wanted to say something?

I also wanted to thank Mr. Edelstein, because I thought one of the reasons you did not support the indemnification proposal was because there was some inherent fault with the insurance idea. That really isn't what you are saying. You are talking about the costs.

Mr. Edelstein. It is the cost and a different sense of fairness. Everybody pays into that program at the beginning, and that may at the margin increase the risks of default, because you are increasing the loan to value ratio.

Miss Kaptur. Mr. O'Toole?

Mr. O'Toole. You mentioned the CBO estimate, and I know earlier the estimate of the $2 billion loss per year got everybody's attention in the room. I think it is important to note that in that estimate, in the consideration of the sale of vendee loans with recourse, that the amount of money received from the sales of those loans was not in that estimate as a revenue. In the estimate the sale was considered as a negative, so it certainly increases what the loss is. In fact VA would be receiving the $600 to $700 million, the amount of money that they would receive for those loans. It is a matter of how the budget scoring is done, but certainly the VA receives the amount of money if those loans are sold with recourse.

Miss Kaptur. Even if the amount would be $750 million in a year, that would still leave you with a shortfall of well over $1 billion.

Mr. O'Toole. Well, that is true, but $1 billion is not $2 billion, and I think the estimate of loss had to be clarified.

Miss Kaptur. All right. Well, as I say, I think we would all benefit by a little bit better estimate of the costs to the Government and to the borrower of any one of these proposals.

I wanted to ask Mr. Perlman from the Home Builders, you have heard some of the talk this morning about numbers, and I know home builders worry a lot about interest rates, and if the Federal Government doesn't do something about its deficit, home sales won't be as high as they could be. We have had to appropriate nearly $1 billion for this program already, and unless we make some changes in the program in the near future, we are going to be faced with those kinds of losses. Are you really advocating, for the Home Builders, that we continue the existing program and the appropriations process?

Mr. PERLMAN. Madam Chairwoman, first there are two points that I would like to make. I would like to agree with my good friend Bob O'Toole, that the question of whether this is an entitlement program or not has to be answered. The way the program exists now, it is part of the compensation that men and women who serve in our armed forces look forward to. Undeniably, they are not the best paid people in the world, so do you look at it on one hand as part of the compensation, or do you look at it on another hand as a gift? I think that the bottom line is that Congress has to make the determination—are we going to give the veterans an entitlement in their housing program?

The second point that strikes me is that we have heard a great number of unanswered questions here this morning. We have heard some programs that have even been developed at the table this morning. It strikes me that we ought to consider the establishment of an independent commission as we advocated in our statement, to concentrate on the proposals we have before us, before we embark on making wholesale changes in the veterans' program. We would strongly recommend that the subcommittee give serious thought to joining with the Senate to establish a commission.

Miss KAPTUR. Well, you know, Mr. Perlman, I like the idea of a commission. The Senate put together a housing task force, and they controlled who was on it. With the OMB that we deal with every day, I have to say I am a little uncomfortable with letting this administration create a commission. If you can help me figure out how to put a task force together of people who believe in housing for the people of this country, you know, I would be real supportive of a commission, but I am not about to let this administration appoint the members of a commission. I guess that's how I feel about that, but certainly in the area of veterans' housing, where we have so little information nationally, I would be very supportive of task force of people that could come together. If we could control it like Senator Cranston did over there recently, then it would interest me.

I wanted to ask Mr. Edelstein, in your proposal one of the issues for us is the tax consequence for a veteran who would neither realize nor roll over all of the gain at the time of sale, because it has been shared with the Veterans' Administration. If the veteran shares a gain with the Veterans' Administration, would that portion also be taxable?

Mr. EDELSTEIN. Well, first of all, it is my understanding that de facto most of the gains are never taxed because when you roll over—

Miss KAPTUR. Most of the gains are—

Mr. EDELSTEIN. Most of the gains are never taxed. If you are talking about veterans buying houses, typically when they sell the house what they do is, they buy a bigger house, and they defer any taxation payment until they are 55 or whatever. Okay? So that is the first point, so what we are really talking about is the calculation of the gain.

What would happen is, just as you would increase your basis in the property if you bought a house and you put a fence in the front yard, and when you sold it the basis would be the original cost of the house plus the fence, now you would add as part of the basis, expenses incurred in the sale, which would be the payback of some fee to the VA. Okay?

So that would reduce the ultimate capital gains obligation of the taxpayer, but in fact what that really means is, it is a calculation for many years down the road. It is not going to have an impact, except it is going to take some money out of his pocket, for sure, when he sells the property, but it will actually reduce the tax obligation as an offset. Under current top rates, if the payment to the VA were $1,000, we are talking about a $280 tax savings.

Miss KAPTUR. As a home buyer, I like that idea. I like the idea of having to worry about it in the future, rather than now.

Mr. EDELSTEIN. As a home buyer, you have discovered finance and present value theory.

Miss KAPTUR. Right. I guess it is the whole idea behind credit cards in America, that the bill always comes later. We seem to like that point of view. You know, one of the other questions I had of you, sir, was that there was a lot of criticism of your proposal, in that it would discriminate or discourage low- and moderate-income buyers. Did you hear that in the testimony?

Mr. EDELSTEIN. I heard that. I mean, I just heard it. I am not sure where that emanates from. There was some perception that there would be an adverse selection, who would take the program and who wouldn't. Again, the fundamental risk is property value risk, and people who have more—the deal that is attractive in having a zero downpayment, I don't think at the margin paying 2.5 percent 7 years from now, on average, when you sell your property, is going to discourage that. I find that is overplayed.

Miss KAPTUR. Thank you.

Mr. Perlman, I just wanted to take you up on your offer of a task force on veterans' housing. If you take a look at the list of people who co-chaired the Senate effort, Jim Rouse I think was the chairman, and David Maxwell from Fannie Mae was the vice-chair, and there were very distinguished people on there like Tony Friedman and Anita Miller, people that have been involved in the housing business for a very long time. If that type of effort could be put together, we would certainly be very interested in it.

Mr. PERLMAN. That is exactly the component that we have in mind by advocating the commission, Madam Chairwoman.

Miss KAPTUR. All right. Thank you very much. You have all been very, very patient. Did anyone wish to say anything else for the record?

[No response.]

Miss **Kaptur**. We thank you very much for your patience today. Believe me, we will take all your comments into careful consideration, and we thank you very much.

I did want to mention that Mr. Burton was unable to attend, and we would request that his statement be included in the record and his questions submitted for the record.

The committee is adjourned.

[Whereupon, at 1:10 p.m., the subcommittee adjourned, to reconvene at the call of the Chair.]

APPENDIX

HON. MARCY KAPTUR, CHAIRWOMAN

SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS

JUNE 16, 1988

THE SUBCOMMITTEE WILL BE IN ORDER.

THE HEARING THIS MORNING WILL FOCUS ON THE SOLVENCY OF THE VA'S HOME LOAN PROGRAM.

LAST YEAR, THE VA GUARANTEED ITS 12 MILLIONTH HOME LOAN, A TRIBUTE TO THE PROGRAM'S SUCCESS. HOWEVER, THE LOAN GUARANTY REVOLVING FUND IS SEVERELY DEPLETED. DURING THE PAST FIVE FISCAL YEARS, THE REVOLVING FUND HAS RECEIVED OVER $2.3 BILLION IN EXTERNAL FINANCING — NEARLY $1 BILLION IN THIS FISCAL YEAR ALONE.

THEREFORE, OUR PURPOSE IS TO DISCUSS REVENUE ENHANCEMENT INITIATIVES WHICH WILL ENSURE THAT THIS PROGRAM CAN CONTINUE TO BE A VETERANS BENEFIT.

I WANT TO REITERATE THAT THIS PROGRAM WAS NOT NECESSARILY INTENDED TO BE TOTALLY SOLVENT IN THE BUSINESS SENSE. HOWEVER, THIS SHOULD NOT PRECLUDE THE PROGRAM FROM OPERATING IN A FISCALLY PRUDENT MANNER.

YOU HAVE EACH BEEN PRESENTED WITH TWO ALTERNATIVES TO FUNDING THE PROGRAM. THE FIRST PROPOSAL INCLUDES THE COLLECTION OF AN INDEMNITY FEE OF 1 1/4 PERCENT FROM VETERANS, ACCOMPANIED BY GOVERNMENT CONTRIBUTIONS TO A SPECIAL ACCOUNT. THE VETERAN WOULD IN RETURN BE RELEASED FROM LIABILITY SHOULD HE DEFAULT ON HIS LOAN. THE VA WOULD ALSO BE MANDATED TO INVEST ANY EXCESS FUNDS. IN ESSENCE, THIS WOULD CREATE A "NEW" HOME LOAN PROGRAM WHEREBY REVENUE GENERATED WOULD BE USED TO OFFSET FUTURE LOSSES, RATHER THAN PAY CLAIMS ON LOANS PREVIOUSLY CLOSED. THIS APPROACH ALLOWS FOR A BUILD UP OF RESERVES WHICH SHOULD IMPROVE THE LONG TERM SOLVENCY OF THE PROGRAM.

THE CONGRESSIONAL BUDGET OFFICE HAS INDICATED THAT THIS APPROACH WOULD CREATE A RESERVE OF OVER $1 BILLION OVER A TEN-YEAR PERIOD.

ANOTHER PROPOSAL WAS PRESENTED AT THE MARCH 17 HEARING BY PROFESSOR ROBERT EDELSTEIN. HE SUGGESTS A "SHARED EQUITY" PROGRAM AS A WAY OF MAKING THE VA HOME LOAN PROGRAM SOLVENT OVER THE LONG TERM. THE CONGRESSIONAL BUDGET OFFICE WAS UNABLE TO COST THIS PARTICULAR PROPOSAL BUT IT IS MY UNDERSTANDING THAT PROFESSOR EDELSTEIN WILL BE ADDRESSING THIS ISSUE IN HIS TESTIMONY.

YOU WERE ALSO ASKED TO SUBMIT YOUR OWN IDEAS FOR THE SALVATION OF THE PROGRAM.

AGAIN, I WISH TO REITERATE MY FIRM COMMITMENT TO THE CONTINUATION OF THIS PROGRAM AS A VIABLE BENEFIT.
I AM FIRMLY CONVINCED THAT THIS PROGRAM IS SALVAGEABLE AND WORTH EVERY BIT OF OUR EFFORT. THEREFORE, I AM MOST ANXIOUS TO HEAR YOUR THOUGHTS ON WHAT DIRECTION THE PROGRAM SHOULD TAKE.

STATEMENT BY THE HONORABLE DAN BURTON
HOUSE COMMITTEE ON VETERANS AFFAIRS
SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS
JUNE 16, 1988

Good morning Madam Chairwoman, esteemed colleagues, distinguished panelists, and guests.

Once again, a great responsibility rests on our shoulders. America's cherished veterans look to us for cooperation in meeting their needs and addressing their special problems. We are privileged to serve on the Veterans Committee where we are uniquely poised to work on behalf of those who have borne arms in our nation's defense.

One issue that has been at the forefront of our concern and attention in recent times is the solvency of of the VA mortgage loan guaranty program. The message is clear, but it is worth repeating. The program is in serious trouble. The program will be in jeopardy if it continues to run these tremendous losses.

I hope and expect that our presence here today signifies a preliminary step towards major reform of the VA Mortgage program. Let us resolve to take a hard look at at the problem before us and to come up with a hard-headed, sensible solution. We have to start somewhere on the road to what I hope will culminate in a major legislative package. As our President is fond of saying: "If not us, who? And if not now, when?"

Today we are fortunate to have very distinguished panels representing a broad spectrum of interested groups. The purpose of our hearing is to begin to consider several draft proposals and to elicit reactions to them.

Our Committee has had an intense and rewarding working relationship with the VA. We are pleased that the VA is almost set to become a Cabinet-level agency, a development which we all helped to bring about. To our friends at the VA we would like to say this:We need your input. We care about what you have to say. But the sands are slipping through the hour glass. You must articulate your proposals fairly quickly, or we will be forced to proceed without you because hundreds of millions of dollars are being lost in a deluge of red ink.

Let me conclude by making one thing perfectly clear: The question is not whether the VA Mortgage loan guarantee programs will continue, but how? We are most definitely committed to continuing this essential program. But it is equally clear that we cannot continue along our present path without fundamental changes.

Rome wasn't built in a day. Let's get moving.

Thank you.

STATEMENT OF

R. J. VOGEL

CHIEF BENEFITS DIRECTOR

VETERANS ADMINISTRATION

BEFORE THE

SUBCOMMITTEE ON HOUSING

AND MEMORIAL AFFAIRS

COMMITTEE ON VETERANS' AFFAIRS

HOUSE OF REPRESENTATIVES

JUNE 16, 1988

Madam Chairwoman and members of the Subcommittee:

It is a pleasure to appear before you again to discuss the operation of the Veterans Administration's housing program. I have with me Mr. Keith Pedigo, Director, Loan Guaranty Service, and Mr. James P. Kane, Assistant General Counsel.

Your invitation letter requested that we comment on two draft bills, plus the proposal made by Professor Robert Edelstein at the Subcommittee's March 17, 1988, hearing.

The first item I will discuss is the draft bill entitled "Veterans' Home Loan Mortgage Indemnity Act of 1988." This bill would establish a new revolving fund known as the Veterans Administration Mortgage Indemnity Fund (MIF). The MIF would pay for all housing loan operations, other than administrative expenses, with respect to loans originally guaranteed or insured after the effective date of the bill. The existing Loan Guaranty Revolving Fund (LGRF) would continue to cover expenses related to loans made prior to the effective date.

The bill would also amend section 1829 of title 38, United States Code, to increase the fee collected from veterans obtaining guaranteed loans from the present 1 percent to 1.25 percent.

The fee for vendee loans would remain at 1 percent, and the fee from persons assuming existing loans pursuant to section 1814 of title 38 would remain at 1/2 of 1 percent. This amendment would remove the sunset for the fee on new guaranteed loans, but would retain the September 30, 1989, sunset for the fee on vendee loans and section 1814 loan assumptions. The exemption from the fee currently provided to service-connected disabled veterans and surviving spouses would be repealed.

Revenues from the increased fee on new loans would be deposited into the new MIF. In addition, there would be credited to the MIF an amount equal to 1/4 of 1 percent of the original loan amount of each loan guaranteed after the effective date of the bill. This credit would be made each year for 3 fiscal years beginning in the year a loan was guaranteed. Since the draft bill does not specify a funding source, it would appear that it would create permanent budget authority; i.e., a permanent mandatory stream of Federal obligations not subject to the annual appropriations process. Any amounts collected by VA with respect to such new loans; e.g., the proceeds from the sale of the property, following foreclosure, would also be deposited in the MIF.

The Secretary of the Treasury would be required to invest the balance of the new MIF not required to meet current expenses in interest bearing obligations of or guaranteed by the United States.

Collections from loans made prior to the effective date of the bill, and fees from section 1814 assumptions of such loans, would continue to be deposited into the existing LGRF.

Finally, the draft bill would provide that veterans obtaining guaranteed loans after the bill's effective date would not have any liability to the Government for a loss following default and foreclosure of the loan.

Unfortunately, in the short time we have had to review the draft bill, we are not able to evaluate and address adequately the many aspects of this proposal. This draft bill would significantly alter the funding of the VA housing loan programs. It would commit the Government to an additional 3/4-point subsidy of each loan over the existing benefit level. In addition, it would further complicate the management of the program between two funds with significantly different funding mechanisms.

VA is well aware that in recent years the costs to the taxpayers of operating this important benefit to veterans has been significant. We share your concern about the future solvency of the Loan Guaranty Program. However, we believe the draft bill should be analyzed further and have identified some of the issues we believe require further study. Some of the potential issues that we would like to investigate further include: the concept of no future liability for veterans who pay the new fee, the requirement that disabled veterans pay the fee, the use of back door financing to pay a Government contribution and the assumption that it would be sufficient to preserve the liquidity of the fund, and the ability of the existing Revolving Fund to pay the costs associated with loans already guaranteed.

Madam Chairwoman, we believe that veterans, like all Federal borrowers, should be responsible for the debt created through foreclosure, and we also believe that the lack of such a responsibility may take away the incentive to pay on a loan from those who could otherwise do so. The liability provisions of the current program provide a strong incentive for veterans to maintain their loan obligations and to cooperate with loan holders and VA in exploring alternatives to foreclosure. Many veterans who have become delinquent make a considerable effort to work out the default through repayment plans which enable them to bring their accounts up-to-date and save their homes.

Others work with VA in pursuing alternatives to foreclosure, such as tender of a deed in lieu of foreclosure or private sale of the property. Adoption of the proposal would remove this incentive. This could result in an increase in foreclosures, an increase in VA's average loss per foreclosure, and a corresponding increase in appropriations.

Under the draft legislation, the Government would be required to contribute one-quarter of one percent of the dollar amount of each loan for 3 years. Creation of new permanent budget authority of this type may run counter to Public Law 93-344, the Budget and Impoundment Control Act of 1974. Also, it is very likely to be insufficient to maintain fund operations, at least in the first several years.

We also do not believe that service-connected disabled veterans should be required to pay the fee. We note that they are not now required to pay the one percent funding fee.

Lastly, without deposit of future funding fees in the existing Loan Guaranty Revolving Fund, it will not be possible to meet the obligations arising out of loans already guaranteed without increased appropriations.

Our concern for the future solvency of the Loan Guaranty Program led us to contract with Peat, Marwick, Main & Co. to conduct a feasibility study of various mortgage insurance options as a cost-effective means of providing the veteran housing benefit. Topics to be explored include the design of a viable mortgage insurance program which maintains its status as a veteran's benefit, the premiums which would have to be charged, who would pay them, the size of a reserve which would be necessary, the total costs of the program, etc. This will involve development of an outline of at least three different approaches to a mortgage insurance program for veterans.

Upon our approval, the contractor will then develop in detail the option chosen by us, including the mentioned items and the effect that implementation of such a program would have on the existing obligations of the Revolving Fund. The study should be fully completed before the end of this fiscal year. We would like to consider your proposal further in conjunction with this study.

Madam Chairwoman, I will next comment on the second draft bill. This measure would change procedures for the sale of vendee loans, waivers of veterans' loan guaranty debts, and restoration of loan guaranty entitlement. It would also state the sense of the Congress on the use of auctions to sell acquired properties.

Section 1 of the draft bill would authorize the VA to sell loans with recourse, or without recourse if the amount received on such a sale is equal to no less than 90 percent of the unpaid balance of the loan. Currently, in order to sell loans without recourse complex, projections must be made of the anticipated yields and costs of recourse and nonrecourse sales of each block of loans to be offered for sale. Based upon such projections, a determination is made as to whether or not it is in the best interests of the effective functioning of the Loan Guaranty Program to sell with or without recourse. After October 1, 1989, VA would be prohibited from selling loans without recourse unless they could be sold at par. For all intents and purposes that would preclude the sale of loans without recourse.

The draft bill would amend section 1833(a)(3) of title 38, United States Code, to, effective on enactment, prohibit the sale of vendee loans without recourse unless the sales price equals at least 90 percent of the loan balance. For practical purposes, this would prohibit loans from being sold without recourse. The Administration strongly opposes this provision.

The Administration's credit management policy favors selling loan assets without recourse. This is because selling with recourse runs counter to effective debt management, provides no incentives for improving loan origination and portfolio management and does not provide an accurate measurement of the subsidy inherent in extending Federal credit assistance. In addition, selling the loans with recourse creates a contingent liability to the Government for the full face value of the loan. This contingent liability represents the possible full extent of the Government's cost for repurchasing vendee loans that eventually default. Moreover, this represents an expensive means for borrowing funds.

Present law imposes complex and costly administrative requirements on VA without tangible benefit. The effective prohibition of nonrecourse sales through a requirement to sell at par, or the proposed 90 percent of par, is an unnecessary and unwarranted interference with the administrative flexibility required by VA to dispose of loan assets. Instead, we believe that the law should be amended to grant the VA flexibility to sell loans in a cost-effective manner, either with or without recourse, without the administrative burdens now contained in law or proposed in the draft legislation.

Section 2 of the draft bill revises the computation of available entitlement after prior use of the loan guaranty benefit. As drafted, this section would eliminate the requirement that for restoration of entitlement the property securing a VA loan be disposed of by the veteran. Only the requirement that the loan be paid in full (or assumed by a veteran transferee) would remain.

In the past we have opposed such a change since our main goal is to assist veterans in obtaining their primary home. To allow restoration of entitlement based simply on repayment of the loan could allow the VA loan guaranty to be used for investment purposes. It is conceivable that a veteran could purchase several homes, keeping some for investment purposes, with VA guaranteed loans.

From informal discussions with your staff, we understand this amendment is intended to assist veterans obtain interest rate reduction refinancing loans. You desire to help veterans who have purchased homes with a VA loan, refinanced it with an FHA or conventional loan, and now wish to refinance again with a VA loan at a lower interest rate. Under current law, these veterans could not have their previously used entitlement restored since they still own the home that secured the original VA loan. Therefore, most such veterans could not now obtain a VA loan in order to reduce their interest rate.

We have no objection to this provision if it were limited to interest rate reduction refinancing cases.

Section 3 of the draft bill would change the standard for considering waiver of a debt established against a veteran as the result of foreclosure of a VA guaranteed loan. Currently, section 3102(b) of title 38, United States Code, permits waiver if "collection . . . would be against equity and good conscience." The proposed amendment would provide that VA could not consider solely a balancing of fault or the future ability of the veteran to repay the debt.

It is our impression that the purpose of this section is to liberalize the criteria for waiver of indebtedness, and our preliminary reading of the section does not convince us that, as drafted, it will accomplish what seems to be intended. While it is difficult to determine the exact intent of this section of the bill, our position is that veterans and all other Federal borrowers should be responsible for repaying their debts to the Government, and we should be very cautious when considering liberalizing waiver provisions.

Section 4 of the proposed legislation provides a sense of Congress as to the use of auctions for selling VA acquired properties. This section recommends that VA refrain from disposing of such properties through auctions and instead concentrate its efforts on disposing of the properties through conventional methods of sale and, where appropriate, lease such properties with an option to purchase. This section would also require a report to Congress within 30 days after enactment containing an evaluation of the feasibility of the recommendations and any legislative action needed for their implementation.

Madam Chairwoman, as you are aware, VA had planned a more extensive use of auctions for the remainder of Fiscal Year 1988. However, the recently enacted supplemental appropriation for the Loan Guaranty Revolving Fund permitted us to reexamine the auction schedule. As a result of our review, we reduced the number of planned auctions and have resumed using our former auction criterion to authorize auctions; i.e., auctions will be used only in those locations where VA has significant numbers of older, hard-to-sell properties which have been in inventory for the longest periods of time and which have not been sold through the efforts of participating real estate brokers. The sale of properties through individually brokered sales will remain our principal method of selling properties.

We have found the auction to be very effective in helping to reduce our older inventory. For example, at the end of Fiscal Year 1984, we had 6,370 properties which had been in inventory over 12 months. At the end of Fiscal Year 1987 we had only 3,403 properties in this category, a net reduction of 47 percent. Not all of these older properties were sold at auction, but auctions were very instrumental in this reduction.

The auction method is used by all the other major participants in the foreclosed property sales market. HUD, FNMA (Fannie Mae), FHLMC (Freddie Mac), and private sector banks and savings and loans all use the auction in their efforts to control increasing and aging inventory. Given the expense of managing properties over long periods of time, it seems unlikely that VA could recoup those expenses by waiting for property prices to rebound in economically depressed areas. In view of this, we do not think it prudent to have VA alone refrain from using that viable sales alternative.

I would also like to offer the following comments on the recommendations to utilize conventional sales methods and to lease properties with incentives such as an option to purchase. Over 95 percent of our property sales during the last 3 years have been made through conventional methods. We believe that this demonstrates our concentration on the conventional sales methods. The leasing of properties with an option to purchase has long been within the discretionary authority of our regional offices. Such leasing is authorized for properties that are not readily salable under normal sales conditions. The most significant barrier to more widespread use of leases with options to purchase is that, in the near-term, they do not provide the same cash flow to the Revolving Fund as do sales. This can result in the need for greater congressional appropriations. In addition, when VA leases property, it may become subject to local landlord-tenant laws. Such laws may require VA to make costly repairs to bring the property up to code, giving VA an immediate negative cash flow with little hope of ever recovering these additional costs. In addition, rent control laws may limit our income and restrict our right to take the property out of the rental market.

The last item provided for our comments was a proposal by Professor Robert Edelstein for a "shared equity" program as a way of making the VA Home Loan Program solvent over the long term. Again we would like to take more time to perform an in-depth analysis of the proposal. However, our initial reaction to the program would lead us to oppose its implementation.

Professor Edelstein's proposal is basically that veterans receiving VA guaranteed loans would be required to give the VA a portion of their profit or equity when they sell the home bought with the VA loan. There would be great difficulty in administering such a program. We would have to audit sales and have a detailed method for determining the true equity or profit, taking into account monies spent by the veteran to improve the property, tax laws, profit based strictly on inflationary dollars, etc.

Since it would be very difficult to predict when veterans would sell their homes, and the amount of profit veterans would make, VA could not accurately project revenues that would be available from this proposal.

In addition, this proposal raises questions as to fairness for the veterans participating in the program. GI loan entitlement is an important benefit which has been earned by veteran home buyers. Only a small fraction of veterans who use this benefit are unable to maintain their obligations and find themselves in default, thereby creating costs to the Government. To, in effect, impose a tax on a veteran's profit derived from the sale of a home, in addition to the tax imposed under the Internal Revenue Code, would unfairly penalize the vast majority of responsible veteran borrowers and would make use of the loan guaranty entitlement far less valuable to them. Many stronger borrowers would likely decide to use FHA or conventional financing rather than surrendering a portion of their equity to the Government, thus leaving those most likely to default as the principal users of the VA benefit. This could lead to even a greater percentage of defaults and higher costs in the long run.

In the testimony we presented at the March hearing, I provided the Committee with an oversight of recent loan guaranty activity. At this time I would just like to bring you up-to-date on some recently implemented changes to the program.

In order to originate better, less risky loans, we recently revised our policy on the use of "buydown" loans. These are loans in which, traditionally, the builder of a new home buys down the interest rate on a mortgage loan for the first 1 to 5 years of the loan. At the end of the bought down period, the monthly payment increases to reflect the true interest rate of the loan. In the past we had allowed such loans to be underwritten based on the monthly payment applied in the first year of the loan. This monthly payment was often much less than the veteran-buyer would be paying in the future. The result was a higher incidence of foreclosures on buydowns. Our revised policy is that the loan will be underwritten based on the note rate or the monthly payment that the veteran will be responsible for at the end of the buydown period. An exception to this is the case where it can be shown that the veteran's income will increase in the future to support the increased monthly payments.

As you know, we have implemented a number of program improvements over the past several years to ensure that we have an effective and viable appraisal system. Recently, to address valuation issues at the liquidation stage, we issued modified liquidation appraisal procedures to 13 regional offices experiencing high numbers of foreclosures for their discretionary implementation in selected areas of their jurisdiction. Briefly, there are three major changes: liquidation appraisals will now be based upon the observed "as is" condition of the property versus our previous requirement that properties be appraised "as repaired"; appraisers must provide an analysis of at least three current competitive listings or offerings in the subject's market area in addition to the three closed sales we have always required; and, if unable to gain entry to the subject property after exercising due diligence, the appraiser may estimate its unseen interior condition in making appropriate adjustments in the sales comparison analysis of the appraisals report. We anticipate that these procedures will provide more accurate liquidation value estimates, especially in areas with soft market conditions. The revised procedures will be monitored and evaluated and, if appropriate, will be extended to other offices.

Recent statistics on defaults reported and defaults pending are mildly encouraging. During the last 3 months, defaults reported fell 8.6 percent from the same period in 1987. The 139,139 defaults pending at the end of May 1988 are 3 percent fewer than the number pending at the end of May 1987. While it is much too soon to call this a trend, we are certainly pleased to see any improvement. VA is also taking further actions to improve the handling of loan defaults. A new release on supplemental loan servicing is being distributed to holders and servicers of GI loans. It emphasizes our policy of encouraging holders to cooperate with veterans to explore all alternatives to foreclosure, and outlines alternatives which are available. These include forbearance, repayment plans, private sale with or without compromise claim payment by VA, and acceptance of deeds in lieu of foreclosure.

The supplemental servicing letters which VA sends to each veteran upon receipt of a Notice of Default or Notice of Intention to Foreclose have been revised to include an explanation of various alternatives to foreclosure. Proposed regulations to implement the provisions of the new law, Public Law 100-198, with respect to foreclosure sale delays and assumption of GI loans have been drafted. Pending final publication of the regulations on assumptions, VA will take responsibility for reviewing the credit and income of transferees and notifying loan holders of the approval or rejection of veteran's proposed transfer of ownership. Instructions for processing these cases will be released to our field stations shortly.

Madam Chairwoman, in March of this year, while appearing before this Subcommittee, I reported on our plans to implement the provisions of Public Law 100-198 relating to innovative uses of the VA property inventory for homeless veterans, job training, and sales with rehabilitation financing. I am pleased to report that the instructions to implement all of these have now been released. It is still too early to have any indication of how these programs are working.

I also wish to note that, during Fiscal Year 1987, VA sales of acquired properties reached a record high of 34,181 properties. During the first 8 months of Fiscal year 1988, sales are running 18 percent higher than during the comparable 8 months of Fiscal Year 1987. If present trends continue, VA will set another program record during Fiscal Year 1988, selling nearly 37,000 properties.

In addition to the Peat, Marwick study that I mentioned earlier, a second study is being made through a consulting contract with Booz, Allen, Hamilton, Inc. It has been initiated to conduct an analytical and statistical validation of the Loan Guaranty budget preparation process. Work is expected to be completed by the end of the fiscal year.

The contractor will analyze and validate the methodology employed by Loan Guaranty to develop its budget submissions for General Operating Expenses (GOE), the funding fee, and the Revolving Fund. As necessary, modifications to the methodology now in use shall be proposed. The contractor shall also develop a computer model which will enable Loan Guaranty staff to accomplish all necessary projections and calculations validly and efficiently.

Madam Chairwoman, this concludes my statement. I would be pleased to answer any questions that you or any member of the Subcommittee may have.

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First Boston

Jonathan Plutzik
Managing Director

Testimony of Jonathan Plutzik
Managing Director
The First Boston Corporation

RE: Various Veterans Administration
Loan Guaranty Program Proposals

Before the House Veteran Affairs Subcommittee
On Housing and Memorial Affairs

June 16, 1988

My name is Jonathan Plutzik. I am a Managing Director of The First Boston Corporation, a full-service international investment banking firm headquartered in New York City. I am also head of First Boston's Federal Finance Group which has primary responsibility within our firm for meeting the investment banking needs of the federal government and its related enterprises. During the last two years First Boston has been actively involved in the federal asset sale pilot program. Most notably for the purposes of today's hearing, First Boston currently serves as co-lead manager of the Veterans Administration's FY-88 non-recourse sale of loans from the agency's vendee portfolio.1/

Based upon this experience, combined with our overall capital markets perspective, we have focused our testimony on one of the legislative proposals that are the subject of today's hearing, namely, the proposal to require that non-recourse vendee loan sales be permitted "only if the amount received is equal to an amount which is not less than 90 percent of the unpaid balance of the loan."

In our judgment, the "90 percent" requirement would effectively preclude non-recourse sales of loans from the vendee portfolio because:

- The stand-alone investment value of the existing portfolio of vendee loans, whether in a non-securitized

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1/ In addition to serving as co-lead manager for the VA's FY-88 non-recourse sale, First Boston currently serves as co-lead manager for the Farmers' Home Administration's loan sale transactions and co-manager for both of the Department of Education's asset sales. We previously testified on February 24, 1988 on the subject of federal loan asset sales before the House Budget Committee and we refer the Subcommittee to that testimony for a fuller explanation of First Boston's views on that issue.

or whole loan format, is viewed by the capital markets as being well below 90% of their unpaid balances.

- In a securitized sale of the vendee loans, even after the use of common and established credit enhancements such as certificate insurance or the sale of subordinated interests, the net proceeds still would be insufficient to return to VA 90% of the loans' unpaid balances.

These conclusions are based upon the characteristics of vendee loan portfolio, the most salient of which are the following:

- high loan to value ratios;
- little "seasoning", i.e. mostly new loans;
- high delinquency and foreclosure rates;
- heavy concentration of loans from "oil patch" states with troubled local economies; and
- existence of installment sales contracts which complicate marketing efforts.

These characteristics prompt investors to demand significant discounts in order to purchase non-recourse VA vendee loans or securities backed by such loans. This phenomenon is not unique to the vendee loan portfolio; rather, it is a basic reality of the marketplace and has been true of the "policy-oriented" loan portfolios of other federal agencies with which we have had asset sales experience.2/

2/ For example, when proceeds are measured against the face value of the loan assets which backed the securities sold to the public, FmHA's FY-87 community program portfolio sale involved a discount approximating 44 cents; likewise, the FmHA's FY-87 rural housing portfolio sale entailed a discount of approximately 35%. On a similar comparative basis the DOEd's FY-87 college facility loan sale too resulted in a 45% discount.

I want to emphasize to the Subcommittee, however, that the existence of these discounts does not mean that the government receives less than fair value for the assets sold. Rather, the discounts represent the judgment of the market --- that is, the considered judgment of large members of investors --- as to the value of on those securities relative to other investment opportunities in the current interest rate environment and the relationship between that value and the specific characteristics of the collateral (i.e. coupon rate, maturity etc.). Therefore, a portion of the discount is attributable solely to the economic realities of the collateral or cash flows being sold. The remaining portion of the discount is attributable to credit concerns of the rating agencies and how those concerns affect investor perceptions of the collateral. These government loan portfolios were not generated on the basis of purely commercial considerations; rather they are the product of public policy. Beyond the normal commercial considerations with which the capital markets are familiar, these "policy oriented" government loan portfolios bear below market coupons, involve lower credit quality borrowers, and are impressed with significant legal restrictions such as borrowers rights considerations.

One strong indication that the federal agencies receive fair value for these sales lies in the fact that the market has not reacted to the issues differently than predicted by the agencies and their financial advisors when pricing the transactions at closing. Had the agencies sold the loans too cheaply, we would expect to see evidence of such in the investors' reaction to the securities already sold into the marketplace.

First Boston believes that any legislative attempt to fix a 90 percent minimum level of receipts for VA's non-recourse sale would be based upon a factually insupportable assumption of the value of that portfolio in the government's hands. We find no basis from the capital markets' financial perspective for assuming that a vendee loan on the government's books with a dollar's worth of unpaid balance is actually worth a dollar to the government if it is sold on a non-recourse basis to the public. Indeed, the empiric evidence accumulated through the FY-87 and FY-88 pilot program now strongly suggests that the market believes that policy-oriented government loans in general may be worth significantly less than their unpaid balances depending upon the coupon, maturity and credit worthiness of the collateral being sold. It is important to note that the same would be true for private securities sold into the capital markets. Considering that if the government keeps the loans it must continue to pay the costs associated with servicing, default, foreclosure and other contingent liability risks, we find no basis for concluding that those loans are worth substantially more to the government than to private investors. First Boston believes the non-recourse asset sales represent a fair measure of the economic value of the government's loan portfolios.

In approaching its FY-88 non-recourse sale VA has exercised great diligence and care in thoroughly analyzing the many complex financial, legal and programmatic issues which were not presented by the agency's very successful program of selling vendee loans with recourse. Its extensive "recourse" experience does put VA in the unique position among federal agencies of being able to generate comparative data with "non-recourse" sales. However, by effectively precluding further non-recourse transactions by VA, the 90% criterion could mean foregoing these potentially very useful comparisons as well as the opportunity to achieve for VA the type of management and programmatic benefits which other agencies have attained through their non-recourse asset sales experience. In particular, we would point to the following types of benefits which have been demonstrated to accrue to the other federal agencies through non-recourse asset sales:

- Aggressive asset management similar to that engaged in by the private sector;
- Thorough self-analysis by the agency of its existing management practices as a result of participation by private sector servicers, rating agencies, and investment bankers. Such analysis can assist the agency develop new and productive approaches in such key areas as loan documentation, loan origination procedures, underwriting standards, and loan compliance and monitoring.
- Productive and efficient re-deployment of limited agency personnel and resources.
- Program cost savings as the agency farms out such activities as loan servicing to the private sector.

Note that these programmatic and managerial benefits of conducting asset sales are quite independent of the level of receipts from those sales. These benefits offer the potential for greater efficiencies and improved service to program beneficiaries in the delivery of government program services, not just in the year of the sale, but rather on an on-going basis.

Conclusions and Recommendations

First Boston's conclusions and recommendations are:

- Non-recourse loan sales are a valid and constructive management tool for the VA and produce fair value for the federal government.
- A requirement that sales proceeds be at least equivvalent to 90% of the unpaid balance would preclude further loan sales from the VA's vendee portfolio, and in so doing deprive VA of real programmatic and management benefits that are otherwise attainable.
- Congress should retain the VA's option to conduct non-recourse sales without a requirement that proceeds meet a pre-ordained minimum level.

On behalf of First Boston, I want to thank Chairwoman Kaptur and the Subcommittee for this opportunity to offer our viewpoints for your consideration. I hope you will call on us if you have any questions or if First Boston can provide any other assistance as you deliberate on these issues which are so important to the future of the VA and its loan programs.

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410

PRESIDENT, GOVERNMENT NATIONAL
MORTGAGE ASSOCIATION

STATEMENT OF MARK E. BUCHMAN

PRESIDENT, GOVERNMENT NATIONAL MORTGAGE ASSOCIATION

BEFORE THE

SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS

COMMITTEE ON VETERANS AFFAIRS

UNITED STATES HOUSE OF REPRESENTATIVES

JUNE 16, 1988

Madam Chairman, and Members of the Subcommittee:

My name is Mark Buchman, and I have been President of the Government National Mortgage Association since March 21, 1988. GNMA appreciates this invitation to present its views on the future of the VA home loan guaranty program. I have with me several of my senior program staff to ensure that any questions you may have following my testimony are answered accurately and completely.

GNMA is a wholly-owned government corporation located within the Department of Housing and Urban Development. We provide a vehicle for channeling funds from the securities markets into the mortgage market, thereby increasing the supply of credit available for housing.

In a nutshell, GNMA guarantees the timely payment of principal and interest on privately-issued securities backed by FHA-insured or VA-guaranteed home mortgages. GNMA has approximately 1,000 approved issuers (lenders), including mortgage banks, commercial banks, thrift institutions and credit unions, located in 49 of the 50 states and Puerto Rico.

Over 95 percent of all FHA and VA home loans are securitized through Ginnie Mae. VA loans comprise about one-third of our business, FHA the remaining two-thirds.

Since the inception of the mortage-backed securities (MBS) programs in 1970, GNMA has issued approximately $480 billion in securities, of which nearly $325 billion are outstanding. There are over 190,000 MBS pools in the marketplace today, making them the most widely held and traded MBS in the world.

While GNMA and HUD Secretary Sam Pierce are proud of GNMA's growth and success, it is important to remember that this tremendous growth brings with it added responsibility--and potential liability--for the United States Government. Our securities bear the full faith and credit of the United States--the only mortgage-backed securities that bear that guarantee. Thus, if an issuer defaults on his obligation to pass through to the investor the correct amount of principal and interest due on the home loans each month (whether or not collected from the borrowers), GNMA steps in and makes the payments itself, thus ensuring that the investors receive their payments.

It is obviously in GNMA's--and the Government's--interests if lenders remain solvent and homeowners remain current in their loan obligations. Thus, we are alarmed at the steadily escalating delinquencies, defaults and foreclosures being experienced by both the FHA and VA programs. Although GNMA is usually able to receive complete indemnification from FHA if a loan goes bad because of the protection added by FHA's self-supporting mortgage insurance premiums, GNMA has less protection in the VA program. This is partially due to the VA's much lower partial guarantee formula. The problem is aggravated when property values have fallen and by the law's "no bid" procedure, which allows VA to remit it's loan guarantee to the lender and require the lender to dispose of the property, rather than selling the property itself.

In effect, GNMA already shares some of the financial risk of the loan guaranty program with guaranteed lenders. Thus, as a general principle, we cannot endorse any change in the VA program which imposes additional risks on the lender, diminishes responsibility of the borrower, or weakens the guaranty fund from the VA's point of view.

You asked for GNMA's comments on the draft legislation and Professor Edelstein's proposal.

Mortgage Indemnity Fund. Your first bill, the Veterans' Home Loan Mortgage Indemnity Act of 1988, would establish a new Mortgage Indemnity Fund for all loans guaranteed after the effective date of the bill. The fee paid by veterans would be increased from 1 percent to 1.25 percent, but the veteran could finance this amount. The Government would also make a contribution of .25 percent for three years.

GNMA is not in a position to state exactly what the fee amount should be. We note that the VA has contracted with a major accounting firm to do a study of various mortgage insurance options. We urge the Subcommittee to examine this report before finalizing the amount of the fee.

We question the advisability of allowing the veteran to finance the funding fee. Many studies have shown that the greater the amount of cash a borrower has committed, the more incentive (s)he will have to maintain the loan and the less likely the default.

We also object to the veteran's being released from liability should (s)he default on his or her loan. This is a sharp and unwarranted departure from current VA practice, and contrary to FHA and conventional loan liability as well. It is important that veterans share in the risk as well as the gain potentially afforded by homeownership under this program. This requires that veterans remain liable for debts created due to foreclosure. It is also grossly unfair to the vast majority of veterans who maintain their loan obligations or cooperate with the VA and loan holders in exploring alternatives to foreclosure.

VA loan sales. We echo the VA's objections to language in Section 1 of the other draft bill which would place additional restrictions on the VA's ability to sell loans without recourse.

As you know, the Administration's federal credit management policy of selling loans without recourse (but, at the same time, for the best possible price) is intended to eliminate the massive contingent liability of the Government for the full face value of the loan. At the same time, selling loans without recourse has little or no effect on borrowers, who are not program beneficiaries but rather buyers of property VA has obtained as a result of default.

Computation of available entitlement. Like the VA, we do not object to Section 2 of the bill, which revises the computation of available entitlement after prior use of the loan guaranty benefit, as long as it is limited to interest rate reduction refinancing cases. I want to point out to the Subcommittee that GNMA itself has initiated a program to reduce the interest rates of borrowers who reside in mobile homes recently acquired by GNMA through the default of twelve mobile home lenders since 1986.

Use of auctions. We also concur with the VA in cautioning against Section 4 of the proposed legislation. This section recommends that the VA refrain from disposing of acquired properties through auctions. As the VA itself points out, FHA, Fannie Mae, Freddie Mac and private sector lenders all view auctions as a last resort, but find them essential to dispose of aged or other hard-to-sell inventory. From Ginnie Mae's own perspective, we have contracted with an auction company to help us dispose of mobile homes which have not been sold through other aggressive marketing techniques. Some homes were vacated as long ago as 1984, and remain empty and unprotected in sprawling lots.

Edelstein shared equity proposal. This proposal would require veterans who have accumulated net equity through housing appreciation to return money to the program in proportion to the level of their gains. While this idea is intriguing, we share the VA's judgment that effective implementation would be an administrative nightmare, requiring exhaustive auditing and possible use of veterans' tax returns to ensure accurate determinations of profit. Annual budget gains would be impossible to predict, with home sales and appreciation amounts, if any, incapable of reasonable estimation.

The VA also raises the specter that more financially secure borrowers and those living in more prosperous areas may well avoid the possibility of surrendering a portion of their equity and use FHA or conventional financing instead. This, in turn, could harm the solvency of the VA fund by leaving it to those most likely to default.

Other efforts. We applaud steps the VA has initiated to improve program administration and limit losses, including tighter appraisal requirements, underwriting "buydown" loans based on the note rates at the end of the buydown period, exploring foreclosure alternatives with veterans, and credit checks for VA loan assumptors.

VA mobile home program. Before closing, I want to briefly address the VA mobile home program, which is structured differently from the VA single family program.

Fundamental program funding flaws, ethical lapses by some mobile home lenders and borrowers, and other factors have aggravated losses flowing from regional economic downturns. As a result, GNMA's traditional and intended mission as a surety for privately-issued securities has been expanded to encompass issuer responsibility, portfolio management and landlord duties across the country for lenders unable to pay mobile home securities investors. The total dollar amount of claims paid by the VA for mobile home defaults has skyrocketed from $2 million in 1979 to $9.5 million in 1983, to $28 million in 1987.

Since 1986, GNMA has been forced to default twelve mobile home issuers owning a collective total of over 100,000 loans in all 50 states. Total GNMA losses under both the FHA and VA mobile home programs are projected to be nearly $102 million in FY 1987 and $225 million in FY 1988.

The Congress acknowledged VA mobile home problems and, ostensibly, the need to limit government losses by reducing the percentage guaranty amount and requiring a five percent downpayment for borrowers under P.L. 100-198. Yet, by agreeing to pool VA mobile home loans originated under the new legislation, we have assumed the risk inherent in a reduction of VA guaranty authority on these loans. Therefore, we are making several changes to strengthen the standards for lender participation in the GNMA mobile home loan program to ensure that lenders will be strong enough to withstand substantial losses and avoid turning their mobile home portfolios over to GNMA. These changes include boosting net worth requirements for participating lenders and setting maximum loan amounts.

This concludes my prepared remarks. We thank you for your leadership and look forward to working with the Subcommittee. I will be happy to answer any questions now or for the record.

Thank you, Madam Chairman.

THE NON COMMISSIONED OFFICERS ASSOCIATION OF THE UNITED STATES OF AMERICA

"STRENGTH IN UNITY"

Statement of

Richard W. Johnson, Jr.
Director of Legislative Affairs

before the

Subcommittee on Housing and Memorial Affairs
Committee on Veterans' Affairs
United States House of Representatives

on

VA Loan Guaranty Program

June 16, 1988

NATIONAL CAPITAL OFFICE
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As the committee meets once again to consider the future of the VA Home Loan Guaranty Program, the Non Commissioned Officers Association of the USA (NCOA) is grateful to be included. NCOA also wishes to express its gratitude to the committee and its staff for the efforts it has made to assure continued operation of the loan guaranty program during times of extreme financial hardship. At issue today is the future of the loan guaranty program. The association has been invited to comment on "discussion drafts" of proposals to replace the loan guaranty program with a loan indemnification program and on a shared equity proposal. However, before commenting on these proposals, NCOA would like to put some historical perspective on the issue.

Background

Through its first forty years of operation, the VA Loan Guaranty Program did not require federal appropriations. Its operation was supported by profits generated from interest on direct loans, by the judicious trading of mortgages on the secondary market and by the profitable sale of properties acquired through foreclosure. Had the loan guaranty revolving fund been left to its independent operation it might still be profitable. Instead, its reserves were tapped to fund deficits in other areas of the budget. Unfortunately, the money siphoned off the loan guaranty revolving fund was not even used to benefit veterans.

When it became apparent that government had dug too deeply into the loan guaranty revolving fund reserves, it began to tax veterans who used the program a fee of one-half of one percent of their loan in a vain attempt to replenish the fund. Soon the fee was raised to one percent. Yet even that amount has proven inadequate to restoring solvency in the fund.

In the opinion of NCOA, veterans have been robbed by government of a viable and equitable home loan program. If it was a civilian program, NCOA believes those responsible would have gone to jail.

Additionally, while NCOA does not believe the current program is beyond salvage, the association is convinced that Congress is more interested in exploring alternatives than saving the current program. Thus, the association is faced with the reality of participating in the design of a new program or being left without a voice.

Mortgage Indemnity

Under consideration today is a proposal to terminate sales under the loan guaranty program in favor of creating a mortgage indemnification program. Relatively few veterans will recognize the difference except for the fee increase.

Fundamentally, veterans would be required to pay a fee of 1.25 percent of the value of their loan to participate in the program. These funds, together with a government contribution of .75 percent of the loan value (made over three years), would be placed in a Veterans Mortgage Indemnity Fund to be held by the Secretary of the Treasury. The fund would then be invested to produce interest income. Both assets and interest earned by the fund would be used to support acquisitions and pay obligations caused by property foreclosures on veterans participants in the program. Fees on vendee loans and assumptions would remain constant as would payout limits to lenders. These would be assets and liabilities on the Mortgage Indemnification Fund.

As noted earlier, few veterans will notice the differences between the current and proposed program. Of course the fee increase of one quarter percent will be of concern to all. Other notable exceptions include disabled veterans and veterans who lose their homes to foreclosure. The proposal does not provide a fee exemption for diabled veterans as was provided under current law. NCOA believes the fee exemption should be continued for the disabled.

Veterans who lose their homes to foreclosure will be the biggest beneficiary of the change.

Indeed, this brings us to the major selling point of the program. Proponents argue that veterans will be getting something for the fee they pay--indemnification against indebtedness to the VA in case of foreclosure. NCOA is concerned that this major selling point may also be the biggest drawback of the program.

Without benefit of VA, CBO or GAO cost and feasibility estimates it is difficult to project how well mortgage indemnification will work. Theoretically, it will be sound based on the FHA experience used in its design. At the same time a recession in housing sales, a bad participation experience caused by high interest, an unusual number of defaults caused by an economic recession or by the program's own indemnification clause could all lead to insolvency. In fact, any number of deficiencies could befall the program or conversely, the proposal might be a tremendous and perpetual success.

Reluctant Endorsement

At its best, the new proposal has the potential to create a large reserve for the prepetual operation of the program. At its worst the program could suffer catastrophic financial failure. At its best, fees could be eliminated, and, at its worst fees could be increased or new laws terminated. In other words, the program has no better potential than the current program and no worse. It is change, perhaps for change sake, which is not likely to significantly impact on veterans.

Accordingly, NCOA reluctantly endorses the concept with the following recommendations:

o Align veterans and government fees at one percent each. It would be more equitable to have government fund at least half the cost of this experiment since poor government and not veterans are responsible for failure in the current program.

o Exempt disabled veterans from fees under conditions and circumstances similar to those provided in current law.

o Specifically prohibit the use of funds for purposes other than specified by law. NCOA does not believe the current language is forceful enough to keep OMB from coveting reserves.

o Specify that veterans fees should be suspended or eliminated when sufficient reserves have been established. Concurrently, provide that government contributions may not be reduced until veterans fees are eliminated.

o Extend to the Administration the authority to make direct loans to veterans as a method of fund investment.

o Provide that at the end of five years an assessment be made on the viability of the Loan Guaranty Revolving Fund and the Mortgage Indemnification Program. Require the Administration to report on the desirability of retaining one system over the other and the desirability and feasibility of merging the programs and associated assets.

Equity Sharing

The committee has requested comments on the equity sharing proposal offered by Robert Edelstein at a prior hearing. That proposal suggests that the VA claim a portion of profit on sale of homes purchased with a VA loan guaranty. Setting aside our objection to the socialistic connotations of the proposal, NCOA simply does not see the concept as feasible. It would be virtually impossible to predict the income from such sales and thus the program would be almost impossible to manage. Flat fees would tax profits at different rates. Losses would not be shared. Those at the lowest end of the economic scale would pay a disapportionately high cost to participate. The least sophisticated homebuyer would be easily taken-in and easily fleeced of profit not necessiarily lost in other financing options. Overall, NCOA believes adoption of equity sharing would lead to the downfall of the loan program.

Other Options

NCOA applauds committee efforts to explore other options. The association strongly supports initiatives designed to curtail housing auctions, heavily discounted loan sales, etc. The association strongly encourages the committee to express leasing and property rental initiatives as law rather than a "sense of Congress". We belive the VA could use the leadership of law on this issue.

Finally, since the door to investment financing has been opened NCOA encourages the committee to explore the issuance of Veterans' Mortgage Bonds as a method of raising capital for program operation. If successful, bond sales, supplemented by reasonable appropriations, could satisfy the cash needs of the program as the current inventory of homes is liquidated. If properly organized and managed, successful bond sales could lead to reestablishment of the direct loan program and re-creation of a profit producing portfolio.

Thank you.

-end-

Statement of

The American Legion

1608 K STREET, N. W.
WASHINGTON, D. C. 20006

by

DENNIS K. RHOADES, DIRECTOR
NATIONAL ECONOMICS COMMISSION
THE AMERICAN LEGION

before the

SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS
COMMITTEE ON VETERANS AFFAIRS
U.S. HOUSE OF REPRESENTATIVES

on

VA HOME LOAN GUARANTY PROGRAM

JUNE 16, 1988

STATEMENT OF
DENNIS K. RHOADES
DIRECTOR
NATIONAL ECONOMICS COMMISSION
THE AMERICAN LEGION

before

THE SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS
COMMITTEE ON VETERANS AFFAIRS
U.S. HOUSE OF REPRESENTATIVES

June 16, 1988

Madam Chairman, The American Legion once again appreciates the opportunity to appear before the subcommittee today to continue the dialogue on appropriate ways of dealing with the substantial increases in the cost of the VA Home Loan Guaranty program over the past ten years. The apparent hemorrhaging of the Loan Guaranty Revolving Fund (LGRF), which since 1984 has required appropriations to remain solvent, has not abated since we last appeared before this subcommittee in March. Fiscal year 1988 has required the largest appropriation in the history of the program, at well over a billion dollars. The Administration's estimated appropriation of $658 million for FY 1989 is hence becoming more unrealistic as we approach the beginning of that new budget year.

During the March hearing, we provided in some detail our analysis of the Home Loan program's funding problems and the development of those problems over the past decade. While it is our intention today to focus chiefly on the proposed legislation, we do believe that several of the points we made in that testimony bear reiteration.

First, the VA Home Loan Guaranty program is, first and foremost, a veterans benefit.

Second, there is a common misperception that the program is a self-sustaining operation which has recently come to grief solely because of poor management and excessive liberality in evaluating the capacity of the veteran to qualify for a VA backed mortgage. By its very nature, the Loan Guaranty program is designed to run at a deficit, except for those unusual years when inflation in real estate values permits the VA to recover both its investment in foreclosed properties, as well as property management costs. The program is therefore by no means a "cost-free" veterans benefit.

Third, the VA's Direct Loan program (which ceased operation in 1981, for all intents and purposes) has for years served as a supplemental income source for its sister Guaranty program when the latter program's expenses exceeded receipts. When this supplemental income was combined with the inflationary spiral in real estate prices between 1962 and 1981, it created the illusion of the Loan Guaranty program as a budgetarily neutral government program. Many of the programs current critics have forgotten that between the passage of the Serviceman's Readjustment Act of 1944 and the creation of the Loan Guaranty Revolving Fund (LGRF) in 1962, Congress yearly appropriated funds to sustain the program. During this eighteen year period, in fact, a total of $730 million was appropriated for such purposes, or more than $3 billion in 1988 dollars.

Fourth, the magnitude of the current funding crisis is directly attributable to the Administration's liquidation of the Direct Loan portfolio during the last seven years, an asset sale designed to help offset growing deficits in the overall Federal budget.

Finally, there are no quick-fixes to the LGRF's red ink which are consistent with maintaining the VA Home Loan Guaranty program as a viable veterans benefit. Policy changes regarding appraisals, underwriting standards, property management and disposal, and mortgage assumptions will certainly help the program; but they will not alone solve its fiscal problems. If the program is to survive in its present form, either LGRF appropriations will become a permanent fixture in the VA's annual budget, or an alternative income source must be found.

Madam Chairman, in our previous testimony we discussed several potential sources of supplemental income for the LGRF, and recommended to the subcommittee that you closely examine the feasibility of rebuilding the VA's property portfolio over the next decade. On May 4, 1988, the National Executive Committee of

The American Legion formalized this recommendation by way of resolution, a copy of which is included with our statement. We believe that a revenue-generating portfolio could be built with vendee loans which are retained by the agency, rather than sold. The Direct Loan program could also be reopened in areas where there is a credit shortage. While this course of action obviously has budgetary implications over the shortterm, it represents a serious longterm alternative to the program's financing problem. It also would constitute no cost to the veteran.

The draft legislation before us today suggests another financing option--the creation of a mortgage indemnity fund, the cost of which would be shared between the veteran and the Federal government. Under this proposal, the current one percent "users fee" charged to veterans to obtain a VA loan guarantee would be abolished. In its place, there would be a one and a quarter percent indemnity fee, which would be supplemented each year for three years by a one quarter of one percent contribution from the Federal government. Although this proposal will impose an additional fee on the veteran buyer, that fee, unlike the present "users fee" will buy indemnity in the event of default. Under present law, the "user fee" purchases nothing, and the veteran is, in effect, paying for the benefit. In addition, in the event of foreclosure, the veteran now also remains liable for the difference between any outlay the VA is required to provide in paying off the guarantee or acquiring the property, and the receipts for its eventual disposition. This current liability has caused hardship for many veterans in areas such as the oil patch where there has been substantial deflation in housing prices.

Thus, we believe that the mortgage indemnity proposal in this draft legislation may have considerable merit. We have several budget questions about the proposal, some of which should be answered by estimates from the Congressional Budget Office. How many years, for example, would be required for the mortgage indemnity fund to have the capacity to handle a foreclosure crisis similar to the one we are presently experiencing? Over how many years could such capability be sustained before the funding base became substantially eroded? Since the current "users fee" is used as an offset against current year LGRF deficits, what are the appropriations implications for the immediate future?

This last question, in our view, is of critical importance. As we have testified previously, no long term solution which seriously addresses the LGRF deficit will result in a major reduction in the fund's requirement for substantial appropriations in the next several years. We believe that both the Congress and the Administration must clearly understand that point, if a serious solution, short of program elimination, is to be tendered at all.

In that regard, it appears to us that the new indemnity fund should come with some built-in protections. First, the fund must be insulated from deficits arising from foreclosures on loans guaranteed prior to enactment of the legislation, i.e., the VA must use indemnity funds only for foreclosures on loans for which the indemnity fee has been assessed. We believe the legislation addresses this issue. Second, the fund must be protected from any use as an offset to Federal deficits in general. In that regard, we might suggest that the the fund ought to be placed in trust to assure that its resources will be solely used for their intended purpose.

Madam Chairman, I would like to touch briefly on some of the proposals contained in the second discussion draft for which you have requested our comments. We are in full agreement with section 1 of that draft, pertaining to the sale of vendee loans without recourse, only if the amount received is not less than 90% of the loan's unpaid balance. The Administration's efforts to restrict loan sales to those made without recourse have resulted in heavily discounted sales which may realize quick cash over the short term, but are poor long term resource management. Recent General Accounting Office studies have demonstrated that such efforts are not cost effective. Similarly, section 4, expressing the sense of Congress concerning the use of the auction as a means for disposing of VA properties is in our judgment the best long term policy for the program. We agree that not only do auctions have detrimental effects on the local economy, but that it would be considerably more cost effective to retain and rent properties until the economy of an area has improved.

We wish to conclude our statement with views on the equity sharing proposal developed by Professor Robert Edelstein and presented at the March hearing. Professor Edelstein presented a penetrating analysis of the problems which have beset the VA Home Loan Guaranty program in recent years. While we are in full agreement with his diagnosis, The American Legion does not find his cure reasonable from the perspective of public policy. Equity sharing has become an increasingly popular vehicle for many Americans who are cash poor, but who can otherwise afford homeownership. As a business venture, it unquestionably has its value, particularly in a society which places such a small premium on savings. We do not believe, however, that equity sharing has any place in the context of a veterans benefit. As we have noted repeatedly, the VA Home Loan program is a veterans benefit, not a business. We find particularly distasteful the suggestion that there should exist an inverse relationship between the amount of equity to be "shared" with the government and the initial downpayment made by the veteran buyer. That relationship is directly at odds with the purpose of the program: to provide those veterans with little credit history or capital with the opportunity to own their own homes. The American Legion is also concerned about how any rational estimate of a program income stream could be developed under this proposal.

Madam Chairman, this concludes our statement. We would be pleased to respond to questions from the subcommittee.

STATEMENT OF
STEPHEN L. EDMISTON
DEPUTY NATIONAL LEGISLATIVE DIRECTOR
DISABLED AMERICAN VETERANS
BEFORE THE
SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS
OF THE
HOUSE COMMITTEE ON VETERANS AFFAIRS
June 16, 1988

MADAM CHAIRWOMAN AND MEMBERS OF THE SUBCOMMITTEE:

On behalf of the more than 1.1 million members of the Disabled American Veterans and its Ladies' Auxiliary, may I say how very much we appreciate the invitation to appear at today's hearing to provide our views on the two draft proposals currently pending before the Subcommittee that address the VA Home Loan Guaranty Program, as well as the "shared equity" program proposed by Professor Robert Edelstein.

The DAV is extremely pleased to have an opportunity to comment on these proposals as possible remedies to the solvency problem of the VA Home Loan Guaranty Revolving Fund, as well as provide some additional suggestions and recommendations that we believe may also address this problem.

However, any change to the current program must, in our view, insure that the fundamental focus of the program -- to assist eligible veterans in obtaining mortgage credit at lower interest rates without a down payment for the purchase of existing or manufactured homes and construction of new homes -- remains fully intact.

In addition, any changes to the current program must absolutely insure that all service-connected disabled veterans continue to fully realize the same benefits which they enjoy today from this important program.

Furthermore, Madam Chairwoman, we are firmly convinced that any legislative and regulatory programmatic changes must be based on sound business and financial practices that protect eligible veterans' entitlement to the program, as well as the American taxpayers' investment.

In this regard, the current Administration has, in our view, employed faulty business and financial practices that have intensified the solvency problem of the Loan Guaranty Revolving Fund. For example, this Administration has consistently pursued (1) a reduction in staffing of loan guaranty personnel; (2) charging large user fees to veterans wishing to utilize the program; (3) selling off large portions of the portfolio assets at bargain basement prices; and (4) seeking the enactment of a major credit reform proposal that would ultimately eliminate the existence of the VA Home Loan Program.

These shortsighted management, business and financial practices, coupled with severe economic downturns in certain areas of the country, fraudulent practices by appraisers and other forms of fraudulent activities (such as equity skimming, kickbacks in the mobile home industry and false credit reporting) have culminated in the current crisis facing the VA Home Loan Program and Revolving Fund.

DISCUSSION DRAFT I

This proposal seeks to amend Chapter 37, Title 38, USC, to establish a mortgage indemnity fund, as well as a mortgage indemnity loan fee.

As we understand the proposal, essentially a mortgage insurance program and fee would be established. Any veteran wishing to utilize the VA Home Loan Program, following enactment of these proposed changes, would be insured from liability to the VA should foreclosure of the VA guaranteed loan occur. In return for this liability insurance, each veteran would be required to pay a fee, equal to 1.25% of their total loan.

In addition, as we understand, the VA would contribute an amount equal to .25% of the total loan amount each year for the first three years of the loan.

The veteran's loan fee, according to the draft proposal, could be paid in full up front, or financed over the life of the loan (with the lender remitting the fee up front to the VA).

As a result of these changes, the proposal would discontinue the current 1% users fee, simultaneously with the enactment of the new mortgage insurance program.

We note that the proposal would continue the current 1% users fee on vendee loans and the half of one percent fee on assumptions, with the purchasers continuing to remain liable.

The mortgage indemnity fees (including the VA's contribution) collected would be deposited in the newly created mortgage indemnity fund, along with collections of principal, interest and the proceeds from the use of property held or sold under this new program, and the Secretary of the Treasury would be required to invest the collections deposited in the fund.

In this regard, we would recommend that the draft proposal be amended to require any and all funds, fines, settlements or penalties collected from any source as a result of schemes that have defrauded the VA Home Loan Guaranty Program should also be deposited in the proposed mortgage indemnity fund.

Madam Chairwoman, the DAV appeared before this Subcommittee on March 17, 1988 and strongly endorsed the establishment of a mortgage insurance fund or pool. And, quite frankly, we are pleased to see that idea in the form of a draft proposal today.

Furthermore, we are delighted to see many of our suggestions embodied within the proposal. However, we are extremely disappointed to note that this proposal would require all service-connected disabled veterans to pay the mortgage indemnity fee.

The DAV fully recognizes that this proposal would provide a significant measure of protection from liability in exchange for the payment of the proposed fee, as compared to the current users fee which provides absolutely none.

However, the DAV believes our nation's service-connected disabled should not be compelled to pay for yet another VA benefit. As you know, recently enacted legislation (Public Law 100-322) will require the application of a deductible, should the VA Administrator decide to provide beneficiary travel payments to service-connected disabled veterans seeking medical care at VA facilities. We view the deductible as a required payment for travel to obtain medical treatment for a service-connected disability.

Madam Chairwoman, should the proposal before you today become law -- what further fees will the Congress seek to impose upon those service-connected disabled veterans who have given of their bodies and minds in defense of our nation? Will Congress impose a fee for medications provided by a VA pharmacy, or will they seek to tax service-connected disability compensation benefits?

The DAV fully understands, as I noted earlier, the serious problem facing the VA Home Loan Program, and we truly appreciate your untiring efforts to find a means to eliminate them. However, Madam Chairwoman, the DAV is adamantly opposed to requiring service-connected disabled veterans to pay for an earned benefit entitlement, as proposed by this discussion draft.

Therefore, the DAV is opposed to the favorable consideration of this discussion draft, unless the Subcommittee amends the measure to exempt service-connected disabled veterans from payment of the mortgage indemnity fee.

DISCUSSION DRAFT II

This discussion draft seeks to amend Title 38, USC, to:

* permit the VA to sell vendee loans with or without recourse, so long as such sales yield 90% or more of the unpaid balance of the loan;

* allow easier refinancing of conventional loans; and

* clarify VA debt waiver considerations to insure equity and good conscience may not be decided solely on the balancing of fault, nor on speculation that the veteran might be able, at some future date, to repay the debt.

The draft proposal also includes a sense of the Congress resolution expressing that the VA:

* refrain from disposing of foreclosed properties through auction; and

* concentrate on disposing of foreclosed properties through conventional methods of sales and, where appropriate, leasing such properties, to include the option for the leasee to purchase.

Madam Chairwoman, the DAV fully supports the provisions of this draft proposal, including the sense of the Congress resolution.

However, inasmuch as the VA's track record reflects an unwillingness (as a result of OMB dictate) to exercise sound business and financial management of the VA Home Loan Program, we strongly urge the Subcommittee to delete the sense of the Congress resolution portion of the draft proposal and include those provisions as statutory requirements.

SHARED EQUITY PROGRAM

This proposal was presented to the Subcommittee during its March 17, 1988, hearing by Professor Robert Edelstein. As we understand Professor Edelstein's proposal:

* current entitlements would remain unchanged; and

* the program would become self-funding in the long run by developing a set of ex-post fees based upon the level of benefits the loan program has produced for each participant.

For example, if a veteran accumulates net equity when he transfers, sells or refinances his property, he would "share" a predetermined percentage of his equity gain with the loan guaranty program (losers would not necessarily be required to pay anything) -- in this way, participants who have accumulated net equity because their property values increased, would return money to the program in direct proportion to the level of their gains.

Professor Edelstein's testimony of March 17, 1988, provided the following hypothetical example of his proposed program -- "a hypothetical numerical example will illustrate how this would work. Assume a VA Guaranty loan is used to 100% finance the purchase of a $100,000 house (including all costs and expenses of home purchase). Thus, the original basis for determining equity build-up over time would be $100,000. After several years, assume that the veteran sells his home for $170,000 (net after expenses and commissions). In essence, the veteran has gained $70,000 in net equity. If the equity sharing percentage between the veteran and the Loan Fund were, say, 10%, the veteran would transfer at sale $7,000 of his $70,000 gained to the VA Loan Program."

Madam Chairwoman, we certainly believe Professor Edelstein is sincere in his belief that his proposal would assist in the long term solvency of the VA Home Loan Program, however, we must express our strong opposition to any serious consideration of the proposal.

Quite frankly, should such a proposal be put into place -- why would any veteran want to use the program? In all candor, we suspect this proposal would only lead to the demise of the VA Home Loan Program and not to its long term solvency.

* * *

Before concluding, Madam Chairwoman, we would like to refer your attention to our testimony before the Subcommittee on March 17, 1988. During that hearing, we emphasized four basic fundamental areas we believe are critical to preserve the integrity of the VA Home Loan Program.

- create a mortgage insurance pool;
- provide sufficient staffing for the VA Home Loan Program;
- require the VA to better manage the program in the interest of veterans and the American taxpayers; and
- increase the number of direct loans the VA is authorized to make.

The draft proposals before the Subcommittee today essentially, with the exceptions previously noted, address two of our four concerns. Unfortunately, the draft proposals fail to (1) insure sufficient staffing for the VA Home Loan Program and (2) increase the number of direct loans the VA is authorized to make. We urge the Subcommittee to give further serious consideration to these recommendations.

This concludes our testimony, Madam Chairwoman. Again, I wish to thank you and the members of the Subcommittee for allowing the DAV this opportunity to express our views on these important proposals.

STATEMENT OF

DENNIS M. CULLINAN, ASSISTANT DIRECTOR
NATIONAL LEGISLATIVE SERVICE
VETERANS OF FOREIGN WARS OF THE UNITED STATES

BEFORE THE

SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS
COMMITTEE ON VETERANS' AFFAIRS
UNITED STATES HOUSE OF REPRESENTATIVES

WITH RESPECT TO

PROPOSED LEGISLATION AFFECTING THE VA LOAN PROGRAM

WASHINGTON, D. C. JUNE 16, 1988

MADAM CHAIRWOMAN AND MEMBERS OF THE SUBCOMMITTEE:

On behalf of the over 2.9 million members of the Veterans of Foreign Wars of the United States and its Ladies Auxiliary, I wish to sincerely thank you for including us in this forum here today which will address the financial health and continued operation of the Veterans Administration Home Loan Guaranty Program. It is, as always, both a pleasure and a privilege to take part in an effort to improve a program which has been so profoundly beneficial to the nation and this nation's military veterans. The Veterans of Foreign Wars remains firmly committed to working for the improvement of this invaluable veteran's program.

First to be addressed today is proposed legislation which is entitled "Veterans' Home Loan Mortgage and Indemnity Act of 1988." In our view, this legislative proposal represents an attempt to drastically revise the loan program and would essentially create a "new" home loan program. The current one percent user fee would be eliminated and replaced with an indemnity fee of 1 1/4 percent, which would be collected from veterans utilizing the program. Additionally, for each housing loan guaranteed or insured under the new program, an amount equal to .25 percent of the original amount of the loan would be credited by the government into the indemnity fund for three fiscal years. This special fund would then be used to pay for the operation of the "new" home loan program and the VA would also be mandated to invest any excess funds so that this revolving fund would become self-sustaining. This new program with its newly established revolving fund would be separate and apart from the current home loan program and, therefore, revenue generated would be used to offset future losses, rather than pay claims on loans previously closed. This approach is intended to allow for build up of reserve which would ultimately improve the long-term solvency of the program.

In this regard, the VFW is on record as supporting enhancing the current VA Home Loan Guaranty Program's assets by increasing its portfolio of vendee loans since they generate collections in the form of principal and interest payments. It is our contention that the current program's problems are directly due to OMB having forced the program to sell off a large portion of its best loan assets in past years, thereby severely eroding its ability to generate its own funding. We still contend that if the program were allowed to rebuild its portfolio of vendee loans, it would eventually become, once again, self-sustaining. However, we also acknowledge that in all likelihood this would take 10 to 15 years. We are also painfully aware of the large appropriations now required to keep the program running. Therefore, creating a "new" home loan program which is free from the current program's OMB precipitated folly and debt makes sense.

The VFW favorably notes that the 1 1/4 percent indemnity fee that would be charged veteran borrowers would in turn release these individuals from liability in the event of default. It is a matter of record that the Veterans of Foreign Wars strongly opposes any increase in the user fee for a VA guaranteed home loan. However, we do recognize that if the current one percent funding fee were replaced with a 1 1/4 percent indemnity fee, the veteran would at least get something for his money. Thus, if a veteran's loan goes into default, the veteran incurs no financial burden. At a time when an individual does not even have enough money to keep his own home, such debt can be absolutely devastating. Therefore, even though we have some concern as to yet unforeseen implications this proposal may have for the program, the VFW strongly supports the implementation of a mechanism for releasing veterans from financial liability in the event of foreclosure.

Taken as a whole, the VFW views this legislation to establish a new and financially independent home loan program as a bold and innovative initiative, which is certainly moving in the right direction toward fulfilling a VFW mandate as enumerated in current Resolution Number 617, entitled "VA Home Loan Guaranty Program" that asks "...that legislation be introduced that will serve to maintain the VA Home Loan Guaranty Program as the most viable and desirable means of home financing for veterans."

We will now comment on the next draft bill contained in the packet provided to us for this hearing which would affect the VA housing loan program.

Section 1 of this bill provides that the Administrator may sell a vendee loan with recourse; or without recourse, but only if the amount received is equal to an amount which is not less than 90 percent of the unpaid balance of the loan. The VFW continues to strongly support the VA selling its vendee loans without recourse since this minimizes the program's financial exposure. However, we also recognize that loans sold without recourse do not command as much money as those sold with recourse and that this can result in the VA home loan program losing money. This is especially true if, say, OMB were to force the VA to sell off a large portion of its vendee loans without recourse at a drastically discounted rate in order to realize a large, one-shot infusion of deficit reducing revenue. Needless to say, though, this would have a very harmful consequence for the long-term functioning of the program. The VFW appreciates the intention behind section 1 and supports its enactment.

Section 2 of this draft legislation is a technical amendment addressing the computation of entitlement allowing for easier refinancing of conventional loans. We support this amendment.

Section 3, modifies the criteria regulating the waiver of recovery of claims by the United States in the veteran's favor. The VFW supports this amendment.

Finally, section 4 of this bill conveys the sense of the Congress concerning the disposal and use of certain VA properties. This section enumerates certain negative effects of using auction as a means of disposing of foreclosed real properties held by the VA. This section also conveys the sense of the Congress that the VA should refrain from disposing of foreclosed real properties through auctions and should concentrate on disposing of such properties through conventional methods of sale.

This section also asks that such properties, where appropriate and necessary in lieu of purchasers, be leased and that incentives such as an option for the leasee to purchase be utilize to achieve this end. Once again, the VFW has testified on numerous occasions in the past that it is of paramount importance for the VA to reduce the amount of time it holds real properties in order to reduce the very high cost associated with their continuing maintenance, protection against fire and vandalism, insurance cost, taxes and so on. We also realize that there are certain parts of the country where viable purchasers for VA held property simply don't exist. Thus, we readily acknowledge that the recommendation to lease these properties may well have merit. Even so, we do have some reservation as to whether the VA should become involved in the rental business. Along with possibly creating the impression that the VA is in direct competition with the private sector, we believe the VA may encounter difficulties in running and managing what would be a nationwide rental agency.

We believe one possible solution to this problem would be for the VA to subcontract with local rental and leasing agencies to run the nuts and bolts operation in the various affected areas. Not only would this ameliorate any perception that the VA is in competition with the private sector, but it would also spare the VA from having to establish a mechanism to look after and run a leasing/rental program. Of course, it would still be encumbent upon the VA to monitor the various private sector realtors and rental agencies to ensure its and the veteran's best interest are being properly served. The VFW recognizes and appreciates that this proposal does have the potential to provide the VA loan guaranty program with much needed revenue while at the same time allowing it to retain certain real properties until they may be sold for their proper value.

The last issue we will take up today is Professor Robert Edelstein's "Shared Equity" proposal. Essentially this plan would require the veteran borrower who accumulates net equity when he transfers, sells or refinances his property to "share" a predetermined percentage of his equity gain with the loan guaranty program. Those veterans who do not realize an equity gain would not necessarily be required to pay anything. Professor Edelstein views this as a means whereby the program may become self-funding.

If the first legislative proposal we addressed today may be characterized as bold and innovative, then this particular scheme can only be described as reactionary and wrongheaded. And, if there is any question as to the legality of imposing what would be in effect a second capital gains tax solely on this nation's veteran borrowers, there is absolutely no doubt as to the relative merit of this proposal--it is a terrible idea. It would be an affront and a serious injustice to tax veterans for utilizing a program that has been provided to them by a grateful nation as recompense for a very special service rendered. With respect to the appreciation of property values, the VA home loan program offers absolutely no advantage over any other loan program. When property values appreciate this reflects the market conditions in the area, inflation and the judgment of the veteran borrower. Why a veteran utilizing a veteran's program should be penalized (taxed) for displaying good judgment in the purchase of a home defies all reason. As a matter of principle, it is absolutely reprehensible. Along with being ethically flawed, this proposal also leaves much to be desired in practical terms. What veteran in his or her right mind would utilize a loan program which will result in their having to pay a stiff tax upon sale or transfer of their home if there is any other kind of alternative financing available. Clearly, the VA would become the loan program of absolute last resort. Not only would loan volume dwindle to an absolute trickle, but those few loans the VA would handle would be for individuals whose financial situation precludes any other form of financing. Thus, the VA home loan program would wind up handling a very small number of loans of which a large percentage would be high risk. As we see, if this proposal is carried out, the VA home loan program would be killed and veterans would loose an invaluable program.

Madam Chairwoman, this concludes my testimony. Once again on behalf of the Veterans of Foreign Wars of the United States, I wish to express our appreciation to you and the other members of the Subcommittee for holding this hearing which is yet another manifestation of the strong and active involvement you have had in attempting to improve the VA Home Loan Guaranty Program. Thank you and I would be happy to respond to any questions you may have.

STATEMENT OF
JOHN C. BOLLINGER, ASSOCIATE LEGISLATIVE DIRECTOR
PARALYZED VETERANS OF AMERICA
BEFORE THE
SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS
OF THE
HOUSE COMMITTEE ON VETERANS' AFFAIRS
CONCERNING
VA LOAN GUARANTY PROGRAM
JUNE 16, 1988

Ms. Chairwoman and Members of the Subcommittee, it is a pleasure for me to be here today to present the views and concerns of the Paralyzed Veterans of America (PVA) regarding the VA Loan Guaranty Program. We appreciate this opportunity and thank you for conducting this most important oversight and legislative hearing.

When this Subcommittee last held hearings on March 17, 1988, concerning the solvency of the loan guaranty program, it was with a certain degree of urgency that we discussed the critical condition of the Loan Guaranty Revolving Fund. Since that time, Congress has, once again, rescued the fund by approving emergency aid in excess of $736 million. Mounting foreclosures continue to deplete the fund, and the VA is likely to need an additional appropriation before the end of this fiscal year.

The VA's budget request for Fiscal Year 1989 of $658 million will necessitate continued emergency appropriations to keep the mortgage fund afloat. At least for each of the next three fiscal years, $1 billion dollar appropriations seem certain.

These figures reflect the critical condition the VA Loan Guaranty Program finds itself in today. There seems to be little doubt that the long range solvency of the program faces certain failure unless the VA, the Congress, the Veterans' Service Organizations, and program participants come to grips with the gravity of the situation. Our collective mission must now be one to save the program. We must be willing to accept change and even to alter the basic program which has, over the years, made home ownership a reality for over 12 million veterans.

This Subcommittee has placed before us today a draft bill which takes a bold step in a new direction. PVA commends you, Chairwoman Kaptur, for your deep concern for the well-being of this vital benefit program. Your dedication to the ultimate success of the program and your desire to study the suggestions of numerous parties who share your concern will, hopefully, result in the salvation of a program which continues to enable a veteran to purchase a home with a degree of financial advantage and protection.

Draft Bill, the "Veterans Home Loan Mortgage Indemnity Act of 1988"

PVA is in agreement with the intent of this draft legislation. We believe its potential effect on the VA Home Loan Program can be one of landmark proportions. Most importantly, if this, or similar legislation is enacted, it will give the program a fresh start down the road toward financial solvency.

The establishment of an indemnity fund lies at the heart of this program. Although we have not reviewed the actual cost analysis, we understand that the program should have a surplus within three to four years. We are hopeful that this estimate represents an accurate appraisal of the fund's success. As the present revolving fund continues to require appropriations in excess of $1 billion per year, it is critical that this indemnity fund establish solvency as soon as possible. We look forward to reviewing the Congressional Budget Office assessments of the proposed legislation.

PVA has, historically, opposed the Administration's efforts to increase the existing one percent funding fee. In addition, we have supported any proposal which provides an exemption to the fee for veterans who are in receipt of service-connected compensation. An exemption to the proposed 1½ percent indemnity fee for these individuals would represent a welcomed enlargement of the total benefit package. However, PVA will not object to the collection of this fee for all program participants, including those in receipt of compensation, if it is determined that such exemptions would jeopardize the success of the program.

We believe the indemnity fee represents a good investment in an individual's financial security as well as contributing to the overall fund. For a comparatively small premium, one is protected from financial devastation due to indebtedness on a defaulted home loan. Coupled with the Government's contribution of ½ percent premium for three years, the total fund, including the treasury's investments, should be sufficient to offset future losses incurred by the VA in connection with the foreclosure of guaranteed loans.

Most importantly, the proposed legislation addresses long range solvency while maintaining the basic philosophy of a "benefits program." The VA would continue to guaranty mortgages for eligible veterans and service personnel and, in addition, provide protection and financial advantage for program participants. The veteran home buyer, for only 1½ percent, has purchased guaranteed release of liability.

PVA continues to be skeptical about renting certain foreclosed properties until market conditions improve. As the Administration's assaults on staffing levels continue to mount, we ask whether the VA can truly operate an additional program to rent properties in areas that are, for the most part, already economically depressed. Regarding the public relations aspect of such an endeavor, significant adverse publicity would easily result as the VA, fulfilling the role of landlord, attempts to resolve the daily problems incumbent in the rental business. Although this concept has some appeal, we cannot imagine the VA managing such a program given the present staffing levels and existing resources.

In lieu of renting foreclosed properties, the VA must aggressively pursue sophisticated marketing techniques to sell such properties. In addition, we believe reinforced efforts must be made to avoid foreclosures in the first place. Special emphasis should be placed on counseling assistance to assist delinquent borrowers retain ownership of their homes.

Regarding the sale of vendee loans, PVA believes the proposed legislation properly addresses this issue. The sale of vendee loans, without recourse, will result in reduced sales prices paid to the government. The government's return will be maximized, however, if vendee loans are sold with recourse. By allowing the sale of the loan portfolio without recourse, but only if 90 percent or better is received, the VA has some degree of flexibility without being permitted to sell at outrageously low prices.

Regarding the "shared equity proposal" under consideration today, the intent of the proposal, and quite possibly the short term effect of such a system, represents a thoughtful and sincere effort to establish program solvency. PVA simply does not support ex-post fees directed at economic winners to accomplish this end.

We believe that ex-post fees unduly penalize a homeowner just because he or she is fortunate enough to realize an increase in the value of the property. We feel certain that the prospect of having to "share" a pre-determined percentage of equity gain with the VA Loan Guaranty Program would prove to be so unpopular, that veteran homebuyers would seek conventional or FHA financing instead of VA financing. Whatever changes are ultimately enacted in the VA Loan Program, we believe they should apply equally to all and be known "up-front" to the perspective homeowner.

PVA commends the Subcommittee for the vigor with which it has undertaken the task of improving this vital VA program. Your oversight and legislative efforts will, we believe, ultimately result in an improved program with long-term solvency.

Ms. Chairwoman, that concludes my testimony. I will be pleased to answer any questions you have.

TESTIMONY

JUNE 16, 1988

HOUSE COMMITTEE FOR VETERANS' AFFAIRS

SUB-COMMITTEE ON HOUSING AND MEMORIAL AFFAIRS

CHAIRWOMAN MARCIA KAPTUR,

MY NAME IS W RONALD EVANS, A CERTIFIED AUCTIONEER AND PRESIDENT/CHIEF EXECUTIVE OFFICER OF CAPITAL CITY ENTERPRISES, LTD; T/A CAPITAL CITY AUCTIONEERS AND CAPITAL CITY REALTY CO. I HAVE ATTACHED A COPY OF MY BIOGRAPHICAL SKETCH FOR THE RECORD.

I AM REPRESENTING THE NATIONAL AUCTIONEERS ASSOCIATION (NAA) TODAY AND I BRING GREETINGS FROM THE NATIONAL PRESIDENT, HASKEL AYERS, THE BOARD OF DIRECTORS; HARVEY L MC CRAY, EXECUTIVE VICE PRESIDENT; AND THE STAFF OF NAA IN OVERLAND PARK, KANSAS.

IT IS WITH GREAT PLEASURE THAT I PRESENT TESIMONY TODAY ON THE MATTER BEFORE THIS SUB-COMMITTEE REFERENCE THE USE OF THE AUCTION METHOD OF DISPOSING OF SURPLUS PROPERTIES OWNED BY THE FEDERAL GOVERNMENT, MORE SPECIFICALLY THOSE HOUSES OWNED BY THE VETERANS ADMINISTRATION.

LIKE ANYTHING THAT IS NEW OR DIFFERENT, THERE IS ALWAYS OPPOSITION. BUT LET IT BE KNOWN THAT IN AUSTRAILIA NEARLY 80% OF ALL REAL ESTATE IS SOLD AT AUCTION.

THROUGHOUT THE UNITED STATES MOST FARMS, RAW LAND AND MAJOR PARCELS OF PROPERTY ARE SOLD AT AUCTION, AND NOT AS DISTRESSED SALES. SO ALL AUCTIONS ARE NOT DISTRESSED SALES OR A LAST RESORT EFFORT. ADDITIONALLY, MANY RURAL AND URBAN RESIDENTIAL AND COMMERCIAL PROPERTIES ARE SOLD AT AUCTION ABOVE THE APPRAISED VALUE.

THE NATIONAL AUCTIONEERS ASSOCIATION, IT'S AFFILIATE, THE CERTIFIED AUCTIONEERS EDUCATIONAL INSTITUTE, AND THE NATIONAL AUCTIONEERS LICENSE LAW OFFICIALS ASSOCIATION (NALLOA) ARE CONSTANTLY EDUCATING THE CONSUMER ON THE AUCTION METHOD AND HOW TO BUY AT AN AUCTION, RECOGNIZING THAT ON THE DAY OF SALE THEY WILL BE PURCHASING AT THE CURRENT MARKET PRICE ON THE DAY OF ACQUISITION WITH HIS/HER COMPETITION STANDING NEXT TO THEM.

ADDITIONALLY, IN THE PRIVATE TREATY METHOD, GENERAL REAL ESTATE BROKERAGE, A BIDDING PROCESS HAS BEEN GOING ON FOR YEARS, (EG. JUST LAST MONTH I SOLD A HOUSE TO A CLIENT TWO THOUSAND DOLLARS ABOVE THE ASKING PRICE. THIS CONTRACT WAS THE SUCCESSFUL "BID"). [REMEMBER IT WAS TWO THOUSAND DOLLARS ABOVE THE ASKING PRICE. HAD I NOT HAD THE EXPERIENCE OF KNOWING VALUE AND RECOGNIZING THAT THE PROPERTY WOULD ACTUALLY SELL FOR MORE THAN THE ASKING PRICE A TYPICAL PROCEDURE IN THE INDUSTRY.] THE AUCTION METHOD IS VERY MUCH THE SAME PROCESS, THE ONLY DIFFERENCE IS THAT THE COMPETITION IS IN THE SAME ROOM AT THE SAME TIME; WITH OR WITHOUT AN AGENT, AND AGENTS ARE ENCOURAGED, TO HELP IN THE ACQUISITION PROCESS. IN MOST MASS AUCTIONS THERE ARE BID CONSULTANTS AVAILABLE TO ASSIST

PURCHASERS WHEN THEY HAVE NOT ENGAGED AN AGENT.

THE AUCTION METHOD ALLOWS THE AUCTIONEER IN MANY CASES TO CLOSE THE TRANSACTION ON THE DAY OF AUCTION WITH LENDERS AND CLOSING ATTORNEYS ON HAND AT THE TIME OF SALE, THUS SAVING TIME FOR THE CLOSING PROCEDURE.

TO LIMIT THE USE OF THE AUCTION METHOD WOULD BE IN FACT A RESTRAINT OF TRADE.

ADDITIONALLY THE LIMITATION OR ELIMINATION OF THE AUCTION METHOD WOULD AFFECT HOW THE UNITED STATES GOVERNMENT HANDLES THE ECONOMY OF THE NATION. THE DEPARTMENT OF TREASURY SELLS TREASURY NOTES AT AUCTION; WALL STREET IS RUN BY THE AUCTION METHOD; LIVE-STOCK, TOBACCO AND OTHER COMMODITIES ARE SOLD AT AUCTION EVERYDAY. THE SALE OF REAL ESTATE AT AUCTION IS NOT NEW AS A MATTER OF FACT, ACCORDING TO THE FIRST HISTORIAN HERODUTIUS, THE FIRST AUCTIONS WERE HELD IN BABYLON AROUND 500 BC.

TO DAY, THE AUCTION METHOD OF MARKETING IS RECOGNIZED AS THE MOST CONVENIENT, EFFICIENT, QUICKEST AND SUREST SYSTEM TO SELL REAL AND PERSONAL PROPERTY IN AMERICA.

AS AUCTIONEERS WE BRING QUALIFIED BUYERS TO THE TABLE TO OBTAIN THE HIGHEST PRICE POSSIBLE AT THE TIME OF AUCTION. THE AUCTION METHOD OF MARKETING REAL ESTATE USES THE ASCENDING MONETARY SCALE WHILE MARKETING REAL ESTATE AT PRIVATE TREATY (GENERAL BROKERAGE) USES THE DESCENDING SCALE. USING THE AUCTION METHOD WE START AT AN OPENING PRICE AND SLOWLY INCREASE TO A MAXIMUM RATHER THAN STARTING AT A MAXIMUM AND MOVING DOWN IN PRICE UNTIL YOU FIND A BUYER.

I WILL NOT TRY TO ADDRESS MY COMMENTS TO THE ENTIRE AGENDA OF THE COMMITTEE TODAY, BUT I WILL RESTRICT MY COMMENTS TO THE QUESTION OF AUCTIONING.

*AT NO TIME HAS THERE BEEN AN ANALYSIS OF THE USE OF THE AUCTION METHOD OVER THE PRIVATE TREATY METHOD. AS A MATTER OF FACT THE USE OF THE PRIVATE TREATY METHOD OR LACK OF IT IS THE REASON THE AUCTION METHOD HAS BEEN EMPLOYED TO ASSIST THE VA IN LOWERING ITS INVENTORY OF GOVERNMENT OWNED PROPERTIES.

WE, THE AUCTIONEERS, RESPECTFULLY REQUEST THAT THE CONGRESS, THIS COMMITTEE AND / OR SUB-COMMITTEE HOLD HEARINGS ON THIS ISSUE SINGULARY BEFORE A DETERMINATION IS MADE ON THE REMOVAL OF THE METHOD USED IN THE DISPOSITION OF SAID PROPERTIES.

THE MAINTENANCE, REHABILITATION AND THE COSTS OF SECURITY OF THESE PROPERTIES COULD MAKE THE PROPERTIES UNMARKETABLE AT CURRENT MARKET PRICES. FOR EXAMPLE MOST HOUSES IN THE PROGRAM HAVE DETERIORATED SO BADLY, MAJOR RENOVATIONS ARE NECESSARY TO MAKE THEM MARKETABLE TO THE GENERAL PUBLIC. THE AUCTION METHOD ALLOWS THE GOVERNMENT TO MARKET THEM ON THE DAY OF SALE TO A NUMBER OF POTENTIAL PURCHASERS, MANY TIMES WITH PRIOR APPROVED CREDIT AND THE UNDERSTANDING THAT THE RENOVATIONS ARE NECESSSARY BEFORE PERMANENT FINANCING CAN BE PLACED ON THEM. ADDITIONALLY THE MARKETING METHOD OF AUCTIONING DOES NOT EXCLUDE OTHER REAL ESTATE PERSONNEL FROM PARTICIPATING WITH THE AUCTIONEER. MOST AUCTIONEERS ENCOURAGE REAL ESTATE PROFESSIONALS TO ASSIST THEIR CLIENTS FOR A COOPERATING COMMISSION.

*THERE IS NO EVIDENCE THAT UNDER CHAPTER 37 OF TITLE 38, UNITED STATES CODE, THAT THERE IS ANY DAMAGE FROM THE USE OF THE AUCTION METHOD. HIGHER PRICES HAVE NOT BEEN OBTAINED THROUGH THE CONVENTIONAL PRIVATE TREATY METHOD. AS A MATTER OF FACT, MANY OF THE PROPERTIES HAVE BEEN ON THE MARKET FOR EXTENDED PERIODS OF TIME PRIOR TO THE USE OF THE AUCTION METHOD.

*THERE IS NO EVIDENCE THAT THE AUCTION METHOD HAS A DETRIMENTAL IMPACT ON THE LOCAL ECONOMY AND PROPERTY VALUES AND THE AUCTION METHOD DOES NOT RESULT IN THE LOWEST PRICE RECEIVED FOR THE PROPERTY. WE HAVE MANY EXAMPLES OF THE OPPOSITE BEING THE RULE.

*AGAIN THERE IS NO EVIDENCE THAT PURCHASERS PLANNING TO PURCHASE A NEW HOME ARE PREVENTED FROM PURCHASING WHEN PROPERTIES ARE CHOSEN FOR THE AUCTION METHOD. INSTEAD WE, THE AUCTIONEERS, ENCOURAGE REAL ESTATE PROFESSIONALS TO PARTICIPATE IN OUR SALES. WE INVITE THEM TO PARTICIPATE IN THE COMMISSION BY REQUIRING THEM TO REGISTER AND ACCOMPANY THEIR CLIENTS TO THE AUCTION. ADDITIONALLY, EXTENSIVE ADVERTISING AND PUBLIC RELATIONS ACTIVITIES TAKE PLACE TO INFORM THE PUBLIC OF UPCOMING AUCTIONS.

I WOULD LIKE TO REFER TO A LETTER ADDRESSED TO YOU, MADAM CHAIRWOMAN, FROM THE OFFICE OF THE ADMINISTRATOR OF VETERANS AFFAIRS, AND I QUOTE:

" IT HAS BEEN OUR CONSISTENT POSITION THAT OUR PRINCIPAL SALES METHOD WILL BE THROUGH INDIVIDUALLY BROKERED SALES." END OF QUOTE, THEREFORE REAL ESTATE PROFESSIONALS ARE NOT AFFECTED AT ALL.

AGAIN I QUOTE MR THOMAS K TURNAGE, ADMINISTRATOR: "AUCTIONEERS, OF COURSE, BELIEVE THAT THEIR SALES TECHNIQUE DOES PRODUCE FAIR MARKET VALUE PRICES. WITH OUR EXPANDED AUCTION SCHEDULE, WE WILL BE ABLE TO EXAMINE THE THESIS THAT SUBSTANTIALLY LESS IS OBTAINED FOR PROPERTIES SOLD BY AUCTION THAN BY BROKERED SALES. THIS THESIS HAS NOT BEEN WELL TESTED IN OUR PAST AUCTIONS, SINCE THE PROPERTIES OFFERED FOR SALE WERE PRINCIPALLY THOSE WHICH HAD NOT BEEN SOLD BY BROKERS AFTER EXTENDED TIME ON THE MARKET." END OF QUOTE.

SO YOU SEE MADAM CHAIRWOMAN AND MEMBERS OF THE COMMITTEE THE ISSUE AT HAND HAS NOT BEEN PROVEN AND WE BELIEVE IF GIVEN THE OPPORTUNITY TO SELL PROPERTIES AT AUCTION AT THE INCEPTION, WE, THE AUCTIONEER/REAL ESTATE BROKER, WOULD ATTAIN EVEN HIGHER THAN APPRAISED PRICES FOR THE PROPERTIES, BEFORE DETERIORATION, VANDALISM AND THE NEED FOR THE EXTENDED LISTING PERIODS.

WE ARE NOT OPPOSED TO THE CONTINUATION OF THE EXTENDED PERIOD BUT WE ARE OPPOSED TO THE ELIMINATION OF THE AUCTION METHOD FOR THE DISPOSAL OF SURPLUS PROPERTIES.

ON BEHALF OF THE NATIONAL AUCTIONEERS ASSOCIATION WE WANT TO THANK YOU FOR THE OPPORTUNITY OF TESTIFYING TODAY AND I WOULD BE HAPPY TO ANSWER ANY QUESTIONS THAT YOU MAY HAVE. IF THERE ARE ANY THAT I AM UNABLE TO ANSWER I WILL BE HAPPY TO RETURN THE ANSWERS TO THE COMMITTEE FOR THE RECORD.

AUCTION

AUCTION IS A WORD DERIVED FROM THE LATIN WORD"AUCTO", WHICH MEANS A GRADUAL INCREASE. AUCTION AS WE HAVE COME TO KNOW IT MEANS A PUBLIC SALE OF PROPERTY TO THE HIGHEST BIDDER. ALTHOUGH NO ONE KNOWS FOR SURE, HERODUTUS, THE FIRST HISTORIAN WRITES THAT AUCTIONS WERE HELD IN BABYLON AROUND 500 B.C., SALE TO HIGHEST BIDDER, MAIDENS FOR MARRIAGE. AUCTIONS WERE WIDELY USED BY THE ROMANS WHO WOULD OFFER WAR LOOT TO DEALERS FOR THE HIGHEST BID.

SINCE BABYLONIAN AUCTIONS, REVOLUTION HAS PLAYED AN IMPORTANT ROLE IN THE AUCTION PROCESS. TODAY, THE AUCTION METHOD OF MARKETING IS RECOGNIZED AS THE MOST CONVENIENT, EFFICIENT, QUICKEST AND SUREST SYSTEM TO SELL REAL AND PERSONAL PROPERTY IN AMERICA.

AUCTIONS ARE NOT LIMITED TO ANY ONE TYPE OF MERCHANDISE, ALMOST EVERYTHING FROM FURS TO SKYSCRAPERS AND WHOLE TOWNS HAVE BEEN SOLD AT AUCTION. NO OTHER METHOD OF MARKETING CAN DISPOSE OF ALL THE MERCHANDISE, OBTAIN THE HIGHEST PRICE, AND HAVE CASH IN A DAY, BUT THE AUCTION WAY!!

THE NATIONAL AUCTIONEERS ASSOCIATION (NAA) WAS FOUNDED IN 1949 THROUGH THE LEADERSHIP OF A SMALL GROUP OF AUCTIONEERS WHO BELIEVED IN THE POTENTIAL OF THE AUCTION METHOD OF MARKETING. SINCE ITS BEGINNING , THE NAA HAS GROWN STEADILY AND NOW INCLUDES MEMBERS IN ALL STATES, THE DISTRICT OF COLUMBIA, CANADA AND OTHER COUNTRIES. NOW, NEARLY 6,000 MEMBERS STRONG, THE NATIONAL AUCTIONEERS ASSOCIATION CONTINUES TO FORGE THE WAY IN INCREASING THE PROFESSIONALISM OF THE AUCTION INDUSTRY.

THE NAA IS AN ORGANIZATION OF MEN AND WOMEN DEDICATED TO THEIR PROFESSION. THEY ADHERE TO THE FINEST PRINCIPLES OF INTEGRITY AND BUSINESS ETHICS, CONSTANTLY SEEKING TO IMPROVE THE METHODS OF AUCTIONEERING TO BENEFIT THEIR CLIENTS. HEADQUARTERED IN OVERLAND PARK, KANSAS, THE NAA NETWORK OF AUCTIONEERS IS READY TO PROVIDE AUCTION BUYERS AND SELLERS WITH THE MOST CURRENT ADVANCEMENTS AND ITS VAST EXPERIENCE IN THE FIELD OF MARKETING, THE AUCTION WAY.

BY OUR STANDARDS, THE AUCTIONEER IS A PROFESSIONAL PERSON WHO HAS STUDIED AND KEEPS ABREAST OF MARKET METHODS AND LAWS. THEY ARE ALSO PROFESSIONAL PEOPLE WHO, LIKE IN OTHER PROFESSIONALS, ARE QUALIFIED AND LICENSED, ARE ACTIVE MEMBERS OF THE NATIONAL AUCTIONEERS ASSOCIATION. THEY ATTEND CONVENTIONS, WORKSHOPS AND SEMINARS THROUGHOUT THE YEAR TO STAY ABREAST OF THE LATEST MARKETS, TECHNIQUES, ADVERTISING LAWS AND THE BEST WAY TO SERVE THE PUBLIC.

AS AUCTIONEERS WE BRING QUALIFIED BUYERS TO THE TABLE TO BRING THE HIGHEST PRICE POSSIBLE AT THE TIME OF THE AUCTION. THE AUCTION METHOD OF MARKETING REAL ESTATE USES THE ASCENDING MONETARY SCALE WHILE MARKETING REAL ESTATE AT PRIVATE TREATY (GENERAL BROKERAGE) USES THE DESENDING SCALE.

USING THE AUCTION METHOD WE START AT AN OPENING PRICE AND SLOWLY INCREASE TO A MAXIMUM RATHER THAN STARTING AT A MAXIMUM AND MOVING DOWN IN PRICE UNTIL YOU FIND A BUYER.

BUYERS INFORMATION:

THE AUCTION METHOD GIVES ALL BUYERS AN EQUAL CHANCE AND BRINGS THEM TO THE MOMENT OF DECISION.

A SUCCESSFUL AUCTION DOESN'T JUST HAPPEN, IT IS PLANNED.

THROUGH PLANNING AND MARKETING PROPERLY, MANY PROPERTIES ARE GENERALLY SOLD ABOVE THE "APPRAISED" VALUE ON THE DAY OF AUCTION. WE MUST ALSO RECOGNIZE APPRAISING IS NOT AN EXACT SCIENCE. FURTHER IT SHOULD BE NOTED THAT MOST REAL ESTATE AUCTIONEERS ARE REAL ESTATE BROKERS, AGENTS AND/OR APPRAISERS. WE ARE MERELY ATTEMPTING TO USE ANOTHER METHOD OF MARKETING WHICH HAS BEEN SO SUCCESSFUL THAT" CAMPUS USA MAGAZINE'S "EDITOR ON JUNE 7, 1988 TOLD ME THAT THE AUCTIONEERING INDUSTRY IS ONE OF THE "BETTER NEW CAREERS" FOR COLLEGE GRADUATES.

IF I MAY DIGRESS I WOULD LIKE TO CALL YOUR ATTENTION TO A FEW MAGAZINE ARTICLES FROM "REAL ESTATE TODAY" NOVEMBER/DECEMBER 1985 PAGE 43. "GOING, GOING, GONE", "AUCTION'S THERE'S MORE TO SELLING REAL ESTATE"; "REAL ESTATE TODAY" JANUARY/FEBRUARY 1987, "AUCTIONING THE SINGLE FAMILY HOME", "AUCTION: WHAT'S IN IT FOR YOU?". THIS MAGAZINE IS THE OFFICIAL PUBLICATION OF THE NATIONAL ASSOCIATION OF REALTORS.

ANOTHER REFERENCE I WOULD LIKE TO MAKE FROM THE OFFICIAL PUBLICATION OF THE NATIONAL AUCTIONEERS ASSOCIATION, "THE QUICKEST WAY TO SELL REAL ESTATE" REPRINTED FROM FORTUNE MAGAZINE OCTOBER 12, 1987, COPYRITE 1987 TIMES, INC. ALL RIGHTS RESERVED. "PUBLIC AUCTION THE SOUND THAT SELLS" BY TOR J. WORSOE, CAI, HOLTSVILLE, NY, MAY 1987. "SELECTING AN AUCTION FIRM FOR LIQUIDATING CHATTELS AND REAL ESTATE FOR BANKS AND ATTORNEYS" BY AL THOMPSON, CAI, WEST HAMLIN, WV, APRIL 1987. I HAVE INCLUDED COPIES OF THESE ARTICLES IN MY FORMAL TESTIMONY FOR YOUR PERUSAL. YOU SEE MEMBERS OF THE CONGRESS, THERE IS OPPOSITION TO SOMETHING THAT HAS NOT BEEN TRIED NOR UNDERSTOOD BY THE VERY INITIATORS OF THIS CONFLICT. I SUBMIT TO YOU THAT THE AUCTION INDUSTRY IS NO MORE OR LESS THAN THE REAL ESTATE INDUSTRY, AND MOST OF US ARE A PART OF BOTH.

BECAUSE TIME WILL NOT ALLOW ME TO ADDRESS THE OTHER ISSUES DESIGNATED IN YOUR INVITATION I HAVE CHOSEN TO SPEND THE BULK OF MY TIME ON THE AUCTION ISSUE. HOWEVER I WOULD SPECIFICALLY AT THIS TIME LIKE TO ADDRESS THE VA LOAN GUARANTY PROGRAM AND THE AUCTION ISSUE.

THERE ARE OBSERVATIONS THAT NEED TO BE MADE REGARDING THE QUESTION OF VOLUNTARY DEED CONVEYANCING AND THE CREDIT WORTHINESS OF THE VETERAN WHO HAS NOW OR IS ABOUT TO LOSE HIS HOME THROUGH THE FORECLOSURE PROCEDURE.

SURELY OUR SERVICE PERSONS WHO HAVE DEFENDED OUR COUNTRY SHOULD BE HELD HARMLESS FOR EXTENUATING CIRCUMSTANCES BEYOND THERE CONTROL AND IF THIS IN FACT THE ISSUE AT HAND THE VETERANS ADMINISTRATION AS OTHER AGENCIES HAVE REMEDIES TO ASSIST IN AVOIDING THE THE LOSS OF RESIDENCE AND CREDIT.

THE VOLUNTARY CONVEYANCING PROCEDURE IS IN PLACE NOW, FOR AS YOU KNOW THE VETERAN CAN EVEN SELL THE PROPERTY AND THE BALANCE OF THE LOAN CAN BE ASSUMED BY A SECONDARY PURCHASER AND/OR THE VETERAN CAN IN FACT VOLUNTARILY CONVEY THE PROPERTY TO THE LENDER IN QUESTION.

STATEMENT OF

ROBERT M. O'TOOLE
STAFF VICE PRESIDENT
RESIDENTIAL FINANCE AND GOVERNMENT AGENCY RELATIONS

of the

MORTGAGE BANKERS ASSOCIATION OF AMERICA

before the

Subcommittee on Housing
Committee on Veterans' Affairs
United States House of Representatives

Oversight and Legislative Proposal Hearing on

The Veterans' Home Loan Guaranty Program:
Establishment of a Mortgage Indemnity Fund
and
A Shared Equity Program

June 16, 1988

Madam Chairwoman and members of the Subcommittee, I am Robert M. O'Toole. I am Staff Vice President for Residential Finance and Government Agency Relations of the Mortgage Bankers Association of America (MBA).* Accompanying me today are Burton C. Wood, MBA's Legislative Counsel, and Linda K. Bumbalo, MBA's Associate Legislative Counsel.

MBA appreciates the opportunity to appear before you today to testify on the state of the Veterans' Administration (VA) home loan guaranty program and on legislative proposals to create a mortgage indemnity fund for new loans and to provide for the sale of vendee loans with or without recourse, as well as on the shared equity proposal of Professor Robert H. Edelstein of the University of California at Berkeley. MBA continues to be extremely concerned about the long-term solvency of the Loan Guaranty Revolving Fund (Revolving Fund), a problem that is of vital importance to all veterans, as well as to mortgage bankers, who are the largest lender segment involved in making mortgage credit available to the veteran participants in the program.

Madam Chairwoman, MBA certainly understands the interest in exploring a new financing mechanism for the home loan program. Under the current system, the burden of sharing the risks associated with loan foreclosures is shared by the lender, the veteran, and the Federal government--the veteran by paying the 1 percent funding fee, the lender by the losses sustained on no-bids, and the government by appropriations. Although all of these parties are bearing heavy cost burdens, the program is still in distress.

Recent heavy losses in the VA Home Loan Guaranty program have prompted efforts to reduce costs associated with the program. Underwriting has been tightened and the funding fee paid by veterans has been increased and consistently extended.

If these losses are to be reduced on future VA loans, the difficult choices that face this Committee are either to reduce the risk of the VA loan guaranty program or to increase the fees. As to the existing VA loans, little choice exists but to share the losses as is currently occurring with lenders bearing losses as a result of "no-bids" and the government carrying the balance of the burden with substantial appropriations. Lenders today are bearing a sharply higher and unfairly burdensome proportion of all losses on VA loans. The average lender loss on a no-bid case now exceeds $16,000.

The draft proposal would re-apportion the risk burden by creating an indemnity fund, which would put more of a burden on the borrower by increasing and making permanent the funding fee, and on the Federal government by appropriating monies for all loans when they are originated. This proposal also leaves in place the no-bid provisions, so lenders will continue to share in the risk burden.

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*The Mortgage Bankers Association of America is a nationwide organization devoted exclusively to the field of housing and other real estate finance. MBA's membership comprises mortgage originators and servicers, as well as investors, and a wide variety of mortgage industry-related firms. Mortgage banking firms, which make up the largest portion of the total membership, engage directly in originating, selling, and servicing real estate investment portfolios. Members of MBA include:

- Mortgage Banking Companies
- Commercial Banks
- Mutual Savings Banks
- Savings and Loan Associations
- Mortgage Insurance Companies
- Life Insurance Companies
- Mortgage Brokers
- Title Companies
- State Housing Agencies
- Investment Bankers
- Real Estate Investment Trusts

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MBA is concerned that this proposal calls for measures that are the equivalent of the Administration's proposals for so called credit reform, which could subject the program to a variety of Gramm-Rudman-Hollings budget procedures, and which will reduce the value of the program in promoting homeownership among veterans. These concerns will be discussed in greater depth later in this statement.

Another alternative facing this Committee is to charge an actuarially sound fee which would be determined based on calculations of what is necessary to cover the losses generated by the program. MBA opposes this approach as it is inconsistent with the entitlement concept underlying the VA program.

If the veteran borrower pays the fee, the entitlement nature of the VA Home Loan Guaranty program would be substantially curtailed. Obviously, an increased fee would affect affordability as well, whether or not it can be included in the financed loan amount.

If either the lender or the seller is made responsible for bearing the cost of the fee, this burden, if borne, would ultimately be passed along to the veteran borrower in the form of higher required yields for lenders or higher sales prices by sellers. Whenever the VA administered rate would preclude lenders from receiving adequate compensation to offset their bearing the cost of the fee, lenders may choose not to originate the loan. If the fee is imposed on a seller and the appraised value will not support inclusion of the fee, sellers may likewise choose not to participate in the program.

Presently, with lenders bearing the cost of no-bids and sellers absorbing discount points in excess of one percent, the ability and willingness of these parties to bear a higher burden and continue to participate in the program is highly questionable.

These approaches too would drastically increase the cost to veterans of participating in the program and eliminate any value in the program in promoting homeownership among veterans. Because this approach is essentially identical to the FHA program, the separate VA program might just as well be terminated and exclusive reliance placed on the FHA programs.

A less obvious solution is to alter the character of the program to reduce the risk, rather than to increase the fees to one or more program participants in order to cover the risks presently associated with the program.

Risk can be reduced by changing underwriting ratios to more conservative levels. Risk can also be reduced by increasing the amount of equity invested in the property by a borrower, i.e. by requiring a downpayment. Numerous analyses of the relative risk associated with mortgage insurance have concluded that the most precise determinant of risk is the amount of borrower downpayment.

A further extension of this concept is to match the funding fee with the borrower downpayment on a sliding scale. A lower funding fee could be assessed on loans with a higher downpayment, while a higher funding fee could be assessed on loans with a lower downpayment. No downpayment loans would carry the maximum applicable funding fee necessary to offset the risk of loss associated with such a loan. The merit of such a proposal is that it preserves the existing benefits offered by the VA loan program with its no downpayment ease of entry into mortgage financing, yet borrowers would bear a burden concomitant to the risk presented by the benefit they would receive.

MORTGAGE INDEMNITY ACT OF 1988

The proposed "Veterans' Home Loan Mortgage Indemnity Act of 1988" (Indemnity Act), which would create a new financial mechanism for dealing with future VA home loans and which would make the VA loan funding fee permanent, would be an alternative to the current Revolving Fund for providing monies to operate the VA home loan guaranty program (the program) in the future. This approach clearly requires close scrutiny by Congress because it could infringe on the historic and statutory "entitlement" mandate of the program.

The Indemnity Act would make permanent the temporary funding fee paid by the veteran for loan origination by lenders and would increase it from 1 percent to 1.25 percent. The funding fee originally was instituted on January 1, 1983, to alleviate the financial stress on the Revolving Fund and has since been increased and extended. With the loss of income derived from direct loans, which were terminated on October 1, 1980, the need for new sources of income arose. Initially established at 0.5 percent, the fee was increased to 1 percent in 1984 and was extended last year, in PL 100-198, for two years until September 30, 1989. Attempts by the Administration to increase this fee have failed. The Administration's budget proposal for FY 1988 had asked for a 2.5 percent fee.

Historically, MBA has called attention to the fact that the fee was not contemplated when the program was instituted, but that a temporary fee may be necessary for the financial stability of the Revolving Fund. In making the decision whether to make the funding fee permanent, Congress should consider whether such action alters the entitlement nature of the program.

BUDGETARY IMPACT OF THE FUND

The legislation institutes what amounts to new user fees for VA guarantees of mortgages initiated after enactment of the bill. This proposal will have several budget impacts. First, it will exacerbate the need for additional appropriations to the existing loan guarantee fund, as there would be no new fee revenue to that fund to offset defaults, and only minimal income from other activities. The VA would be under pressure to increase sales of VA-acquired properties to increase immediate revenues to the fund. This latter policy can result in excessive VA property sales in troubled market areas, which can further depress regional market values and consequently reduce long-term revenues to the fund.

In addition, the implementation and implication of the separation of fee revenues to the new fund and the provision of the Federal government's 25 basis point share are uncertain. There is no specific authorization for appropriations, and it is unclear how the additional three quarters of a percent three year premium will be provided. Presumably, the VA will make some estimate of the total dollar amount of loans to be originated in a given fiscal year, and request an appropriation for that amount. It is not clear what would happen if the projection was too low. While we would hope that the VA would not be precluded from guaranteeing loans if the Federal share of the VA guarantee premium fell short because a projection was inaccurate, we anticipate that would be the case. In this respect, the proposal has a striking similarity to the Administration's credit "reform" proposal mentioned above.

The Administration's FY 1989 budget indicated that the Administration planned to submit a legislative proposal to identify the "grant equivalent" subsidy of Federal credit (direct loan, loan guaranty, and insurance programs). While that legislation has not yet been transmitted to the Congress, the budget indicates that it would quantify a claimed "implicit subsidy" for guaranty programs, and require an upfront appropriation of that amount. That grant equivalent subsidy was allegedly to recognize the "favorable financial terms" of guaranty programs, compared with the terms under which borrowers obtain loans from private lenders. MBA has always opposed such credit legislation both because it overstates the actual dollar costs of the program, and because the timing problems associated with estimated upfront appropriations would arbitrarily prevent program recipients applying late in a fiscal year from receiving assistance. Clearly, these latter timing problems could occur under the Mortgage Indemnity Fund proposal. The proposal also represents a step away from a true entitlement program and toward the Administration's philosophy of credit subsidy estimates, attempting to place a value on the Federal guarantee.

In addition, the proposal reverses a modification to the loan program which the Congress instituted last year. In the "Veterans Home Loan Program Improvements and Property Rehabilitation Act of 1987", (P.L. 100-198), Congress exempted the VA loan guarantee programs from sequestration. Sequestration is the process by which across-the-board cuts are instituted if Federal deficit levels exceed targets established by the Gramm-Rudman-Hollings Deficit Reduction Act. Under sequestration, the budget authority provided to the new loan fund from fees paid by the borrowers and from the federal appropriation would automatically be reduced. If sequestration were put into effect in a given fiscal year, not only would it arbitrarily reduce the veteran's own contribution, the resources to the VA would be reduced, and the number of loans originated would accordingly be reduced. This automatic reduction could occur, as in 1985, at a time when the demand for mortgages is very high. Consequently, as in the case where projections were simply inaccurate, veterans fully eligible for the guarantee program and entitled to the guarantee as a benefit would not be able to obtain a

VA guaranteed loan. However, here, this could occur because the deficit was too high for reasons completely unassociated with the VA program.

The draft bill also proposes to release from liability to the VA, in case of default on the VA loan, any veteran who pays the permanent fee. There are several issues associated with this proposal. First, MBA would like to point out that one element of the incentive to keep a loan current is the consequence of being responsible for payment of the debt in any event. Congress should make a conscious decision about the effects of a government policy where borrowers know in advance that there is impunity in case of defaults on their loans. One question that needs to be addressed in such a context is what impact a release from liability to the VA for VA loans would have on other government loan programs. Consideration should be given to granting the VA the option of releasing veterans from liability on a case-by-case basis.

Second, the proposed release from all liability would apply only to properties acquired by the VA. Thus it would create a bifurcated loan program. In cases where the lender acquires the property, under the no-bid formula, the VA would pay the lender only the guaranty claim. In such cases, borrowers are not released from all liability. Furthermore, lenders, who stand to lose a good deal of money in such cases, would oppose a blanket release from liability for borrowers. This release must be justified on the basis of a case-by-case determination. Although this class of veterans would have paid the same permanent funding fee as defaulting veterans whose property is acquired by the VA, these veterans would not be released from liability with respect to losses resulting from the loan for which the VA has not reimbursed the lender. The veteran's release from all liability, therefore, is conditional on whether the foreclosure results in the VA acquiring the property. No-bids result in cases of loans with the greatest losses, and it is these veterans who would not be released from all liability. It is the veterans with relatively lower losses who would be relieved from all liability.

There would be consistency to the insurance nature of the proposal if the VA would acquire the property and pay the full loan amount to the lender in every case of foreclosure. All veterans would be relieved from all liability. There is no rationale for the no-bid formula if the purpose of the Indemnity Act is to release veterans from liability in exchange for paying a permanent loan fee. By maintaining the no-bid formula, the proposal only grants the veteran a contingent release from liability.

OTHER LEGISLATIVE PROPOSALS

In addition to the Indemnity Act draft bill comments, MBA would like to comment on the legislative proposals contained in the second discussion draft bill that would make changes to existing law.

MBA believes that the proposal to sell vendee loans with or without recourse, as long as at least 90 percent of the loan value is received, is reasonable. The concern MBA has, however, is that this percentage could be reduced in the future.

The proposal to amend Section 3102 (b) of Title 38 of the USCA, dealing with the granting of waivers of recovery of claims against veterans by the VA, would be helpful to veterans. Currently, the VA is authorized to waive payment of the veteran's indebtedness to the VA if it determines such collection would be against equity and good conscience. The proposed amendments would expand the factors used by the VA in making this determination beyond the balancing of fault and whether the veteran might be able to repay the debt. By using additional factors, the VA would be encouraged to grant more waivers to deserving veterans.

MBA supports the sense of Congress proposal contained in the discussion draft concerning the disposal of VA-acquired properties by auction. MBA agrees that such practices have negative effects on the loan guaranty program and on local economies and property values. The disposal of properties by the VA should be done by a more orderly method that preserves property values. MBA agrees that the VA should, in appropriate cases, lease properties with incentives, such as an option to purchase the property.

SHARED EQUITY PROPOSAL

While MBA does not oppose the shared equity concept proposed by Professor Edelstein as an option under the VA loan guaranty program, MBA would like to offer its technical analysis of the proposal. Under this concept, veterans would pay "fees" for the loan program when the home is sold (based on their gain), rather than when the home is purchased and the loan is originated. One of the first questions that needs to be answered in exploring this proposal is how many veterans would be interested in participating in such a program.

MBA believes that the proposal, as explained, may be reasonable in theory. There are further issues, however, that would need to be resolved. The shared equity proposal assumes that a veteran is going to sell or transfer the home or refinance the loan; in other words, there will be a future transaction that will measure whether the veteran has increased the equity in the home. This may not happen for many years, if at all.

A second issue to be resolved is the tax consequence for a veteran who would neither realize nor roll over all of the gain at the time of the sale because it has been shared with the VA. When a house is sold at a gain, the gain is either realized as taxable income or rolled over into another residence and not realized at that time. If the "rollover of gains" tax provision (Section 1034 of the Internal Revenue Code) is not applicable, the veteran has to pay capital gains tax on gain realized. A determination would have to be made whether this gain amount should be reduced by the amount of the "fee" given to the VA. On the other hand, if the veteran buys another principal residence with a cost equal to or greater than the sales price of the previous home, the gain from the previous home is "rolled over" and not realized at that time. If the veteran shares that gain with the VA, would the portion that is shared be realized and taxable? The tax consequences of this proposal would need to be studied in detail.

A third issue is the ability of the VA to enforce its right to the "fee." It is a fee that is contingent on a future transaction occurring and, if it occurs, on the contingency that there is a gain, the amount of which cannot be known until the event occurs. If there is a determination that there is gain, a share of which the VA is entitled to, the question remains about what legal mechanism the VA would have available in order to enforce its rights.

The percentage share of the gain is very high compared to the current fee. Because there is no fee if the property is devalued, those who pay a higher fee cover the costs of those who default. This does not solve the program's problems and is too experimental at a time when the program is in a crisis.

SOLVENCY OF THE REVOLVING FUND

The Indemnity Fund proposal does not address the current and/or future financial problems facing the Revolving Fund. In fact, it removes a current source of revenue--the 1 percent funding fee--the effect of which would be to make the Revolving Fund even more dependent on appropriations. These increased appropriations and the proposed new Indemnity Fund appropriations would make the VA home loan program appear more costly at a time when budget considerations are extremely sensitive.

Madam Chairwoman, MBA would be extremely remiss if we did not call to your and the Subcommittee's attention a serious problem costing the government, as well as lenders, a great deal of needless expense. That problem is the lack of VA personnel, particularly trained personnel, to administer the home loan guaranty program. This problem is particularly acute in those geographic areas suffering economic distress. The expense of additional trained personnel would be far more than offset by the savings realized in prompt and efficient processing of claims and property disposition. MBA, in its testimony before the Subcommittee on March 17, 1988, made recommendations regarding program management that would help the solvency of the Revolving Fund. MBA reiterates that efficiencies in program management, including adequate staffing and equipment, plus sound financial decisions with a long-term perspective could not but help to improve the financial position of the Revolving Fund.

MBA appreciates the opportunity to testify before this Subcommittee and would be happy to answer questions or provide additional information, as necessary, for inclusion in the hearing record.

STATEMENT OF
THE NATIONAL ASSOCIATION OF HOME BUILDERS
before the
COMMITTEE ON VETERANS AFFAIRS
SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS
U.S. HOUSE OF REPRESENTATIVES
on
OVERSIGHT AND SOLVENCY OF THE
THE VA HOME LOAN GUARANTY PROGRAM
June 16, 1988

Madam Chairwoman and Members of the Subcommittee:

My name is Martin Perlman and I am Vice President and Treasurer of the 150,000 member National Association of Home Builders. I am a builder from Houston, Texas and have been active in the homebuilding industry and the VA Home Loan Guaranty Program for over two decades.

Madam Chairwoman, it is a pleasure to again appear before you. I am pleased to present our views concerning solvency of the VA Home Loan Guaranty Program including the establishment of a loan indemnification program and a shared equity plan for veteran homebuyers. I am also pleased to have this opportunity to comment on legislation in opposition to disposing of VA properties through auctions.

LOAN GUARANTY REVOLVING FUND

Madam Chairwoman, there has been concern that the Loan Guaranty Revolving Fund (LGRF) has required appropriations over the past few years to sustain the viability of the VA Home Loan Program. A short background of the program describing the reason for the establishment of the home loan benefit and history of the revolving fund is necessary when evaluating the future of the program.

The VA Home Loan Guaranty Program was enacted in 1944 by Congress to assist veterans returning from World War II to purchase housing. They did not have the opportunity, while in service to our country, to save for a downpayment for a home. Nor were they able to establish a credit rating to enable them to go to a financial institution of their choosing to obtain a loan. Because of their dedication Congress passed the Servicemen's Readjustment Act so that veterans returning home would have equal opportunity to buy a home when entering the homeownership market.

From the inception of the program in 1944 until 1961, the VA Home Loan Program was funded through appropriations. It was then that the Loan Guaranty Revolving Fund came into existence to provide funding for the program. Up until the past five years, the program under the LGRF was self-sustaining.

A number of factors can be attributed to the losses the LGRF is now experiencing. First, the general incidences of severe downturns in regional economies since the early 1980's, for example, in the Great Lakes area and in the oil and agriculture dependent states today, have caused high foreclosures and claim rates. This has precipitated drains on the revolving fund which require additional appropriations. We are pleased that Congress has provided the necessary funds to sustain the program in FY'88 and urge that adequate funding be provided in FY'89 as well.

Second, the flow of income to the fund has been altered by Administration policies. The Direct Loan Revolving Fund (DLRF) which supplemented the LGRF was terminated in 1981. It was common practice for transfers to be made from the DLRF to the LGRF when a deficit occurred. Additionally, the Administration is requiring the VA to sell its vendee loan portfolio, (direct loans made to new buyers to purchase foreclosed homes) which will no longer bring in principal and interest payments, disrupting the income stream formerly realized by the Loan Guaranty Revolving Fund.

ENTITLEMENT NATURE OF PROGRAM

It is important that the VA Home Loan Guaranty Program be sustained and run in an efficient manner. It is also important, however, that the entitlement nature of the program be acknowledged when seeking program improvements so that this VA benefit will continue to be effective in attracting qualified men and women into the service. We do not believe that temporary increases in foreclosures or downturns in certain parts of the country should lead to a cutback in the benefits of the program. Instead, Congress should focus on the long term goals and performance of the VA Home Loan Guaranty Program and evaluate program changes on that basis.

Such a review must recognize that the nature of an entitlement program is fundamentally different from that of traditional financing programs, and requires a higher level of commitment from Congress. Therefore, while NAHB continues to support deficit reduction as a means of keeping interest rates down, and of creating a stable economic environment, we believe it is appropriate that the Loan Guaranty Revolving Fund be supplemented by appropriations when necessary.

We also urge that any changes to the operation of the program in the future be carefully done without jeopardizing the entitlement nature of the VA guaranty. In the interim, we believe it is appropriate to continue to support appropriations for the program and to oppose increased fees to supplement the fund. We appreciate your commitment to looking at other alternatives to the current one percent fee which has the effect of eroding the entitlement nature of the program.

INDEPENDENT HOME LOAN GUARANTY COMMISSION

Earlier this year we testified before the Senate on S. 2049 in support of creating an Independent Commission on the VA Home Loan Guaranty Program. The Commission's charge is to look into ways of improving solvency in the Loan Guaranty Revolving Fund, improving program benefits and assistance to veterans, reducing defaults and foreclosures, and disposing of VA properties in a cost effective manner.

We commented on the following areas where we feel the Commission should act: solvency in the Loan Guaranty Revolving

Fund while maintaining the entitlement nature of the program; the piecemeal approach of placing fees on VA home loans; alternative mortgage instruments and the impact of property disposition efforts on new construction. A Commission would lend itself to addressing these and other concerns surrounding the program. We urge you to consider the Senate passed bill to establish an Independent Commission which could provide other alternatives to make improvements and seek new solutions to problems in the VA Home Loan Guaranty Program.

It is our understanding that the VA has commissioned feasibility studies to look into ways of making the VA program operate more efficiently. These reports include a study to make the program self-sustaining and a study on nonrecourse loan sales. We would recommend that Congress and the Commission carefully assess these reports before passing additional legislation.

COMMITTEE PROPOSALS

Madam Chairwoman, you asked us to comment on alternative methods of funding the VA Home Loan Guaranty Program to try to make it self-sustaining. Leading these possibilities are a proposal to restructure the current benefit program to a loan indemnification program and a shared equity plan.

Although NAHB has not established firm policy on these matters, it is likely that NAHB would oppose both of these proposals as they substantially alter and erode the entitlement nature of the VA Home Loan Program. Congress should directly confront the issue of whether the program is to be an entitlement program and not attempt to cloud the issue under the guise of program self-sufficiency.

Loan Indemnification Program

The mortgage indemnification program will fundamentally change the entitlement nature of the VA Home Loan Guaranty program. Moreover, this change will occur without achieving its required objective of making the program actuarially sound.

Under the Committee proposal the veteran would no longer pay a 1 percent funding fee, but would instead pay a 1 1/4 percent indemnification premium. The government would "share" in this Program by contributing a 3/4 of one percent premium over a three year period. These collections are to be placed in a second revolving fund called the Administration Mortgage Indemnity Fund. Premium collections would be used to establish a reserve fund to offset future losses from foreclosures and the veteran would be absolved from debt should the loan go into default.

While this proposal has the appearance of working, there are many drawbacks.

1) The veteran would simply be substituting a 1 percent funding fee for a 1 1/4 percent "indemnification fee".

2) A two percent indemnification fee (including the 1 1/4 percent veteran fee and 3/4 percent government fee) may be insufficient to cover losses in the program on the new loans. The indemnification premium would have to be higher to make the

program actuarially sound. In all likelihood, some initial capital infusion or additional appropriation may be necessary.

- Since the program does not provide for capital to start up the reserve fund, it will likely be underfunded from the beginning.
- Because the VA Home Loan Guaranty is a no downpayment program a premium increase would likely be needed from the beginning. For HUD programs to be actuarially sound a 3.8 percent premium is collected and that program requires a downpayment. It has also accumulated substantial reserves over the years.

3) Two revolving funds would now exist and neither one would be self-sufficient. The Loan Guaranty Revolving Fund, which is not backed by loss reserves would continue to need infusions to pay for past losses. The LGRF would no longer benefit from new loan fees coming in to supplement the fund. The Indemnity Fund not only does not help supplement the LGRF but would require appropriation for the government's share of the premium. The federal government would then have to appropriate funding for two separate revolving funds that are not self-sustaining.

4) Funds from the loan indemnification program are to be deposited at Treasury rather than in a separate fund at VA. Assets from the premium may end up being used to offset Treasury losses rather than VA losses. The same problem existed when the

funding fee went into the Treasury the first year it was enacted. Congress later changed the law requiring the fee to be directly deposited into the LGRF.

5) If the Indemnity Fund is made permanent there would be no entitlement and it would increase costs to those who need the program the most.

Starting from the premise that the VA program must be either "self-sufficient" or "solvent" goes against the concept of an entitlement program. Under current law and policy, a veteran is entitled to the benefit of the VA Home Loan Guaranty Program because he earned it in service to our country. If the program suffers losses because of economic declines which cause defaults and falling real estate values or produces high interest rates, then Congress should appropriate the funds necessary to cover those losses.

Shared Equity Loan

The shared appreciation mortgage envisioned by Dr. Robert H. Edelstein of the University of California at Berkeley has the same major drawback for the veteran as the Indemnity Fund plan. We have already raised the issue of whether the VA Loan Guaranty Program is to remain as an entitlement program or become self-sufficient.

Under Dr. Edelstein's equity payback plan a veteran borrowing on a VA guaranteed loan would be required to share a portion of the profits on the total appreciation when the home is sold, in direct proportion to the percent of downpayment.

If, for example, a veteran received a no downpayment loan, he would share 10 percent of his equity gain with the government. But, if he made a 10 percent downpayment he would only be required to pay a 2 percent share of the gain. Veterans with no appreciation or who experienced disinflation would pay nothing.

We feel the program is flawed for the following reasons:

1) Even if there is a gain on resale, and gain must take into account the cost of capital improvements and sales costs, it is not necessarily a windfall gain. A veteran may have sold the home to purchase another in the same area. In such a case, those homes may have risen in price by as much or more, completely offsetting the gain made by the veteran on the home sale. Taking away some of the gain could leave the veteran in a worse position than on the initial home purchase.

2) The concept of tying the amount of equity sharing to the amount of downpayment is also flawed. There is no incentive for veterans to use the program if the downpayment still must be accompanied by a return of some equity profits on resale. This occurs even when as much as 10 percent has been put down on the purchase. Veterans able to make downpayments would instead use FHA or conventional loans rather than give up equity gains. A shared appreciation mortgage has the effect of making the "no downpayment" mortgage financing entitlement less attractive and would likely reduce use of the program.

3) It is a disincentive for a veteran who is trying to keep ahead of inflation to know that he may not realize the full value of his property. The veteran may have no incentive to stay

in his home, and would be more apt to walk away from the loan, if the appreciation must be shared. Because of my experience in the Houston area, where, because of the economic situation, there is little or no appreciation in the value of the home, I am pleased that the shared equity plan does not impose a burden on the veteran who experiences disinflation or a drop in home value.

4) The proposal is also inequitable because it would require veterans in parts of the country where the market is stable, and where home values have increased to pay for the program in areas of the country where there are severe downturns. This would jeopardize the entitlement nature of the program for veterans in certain parts of the country.

DISPOSITION OF VA PROPERTIES/FORBEARANCE

Auctions

Madam Chairwoman, we are adamantly opposed to auctions for selling foreclosed properties in distressed areas. We support the sense of Congress legislation in the Committee Print concerning the disposal and use of VA properties.

Last month our Board of Directors passed policy opposing bulk real estate auctions (Attachment A). We stated that auctions cause unnecessary devaluation of property throughout the marketplace and contribute to a downward spiral of additional foreclosures and property devaluations.

For example, when the Veterans Administration sharply reduces home prices or sells them at auctions on a bargain basis, it reduces the value of the home next door and other properties in the surrounding area. A veteran, for example, who has $60,000 left to pay on his loan with no hope of recapturing his equity would certainly consider walking away. It makes no sense for him to continue making payments on his loan which may only be worth 50 percent of its original value due to the VA's "dumping" practices. This adds more homes to the VA's foreclosure portfolio which compounds an already growing inventory problem in areas of economic distress. It creates a domino effect of continued foreclosures.

In our resolution we ask that alternative programs for the disposition and use of foreclosed properties be developed. In the Committee Print you mention leasing properties with incentives, including an option for the lessee to purchase.

We feel that renting properties with the option to buy is a viable alternative. Everyone wants to buy a home for their family and this would be a means to provide for that possibility. It is workable if the buyer would have to meet standard qualifications for the purchase. It is even more viable if a portion of the rent is applied toward a reduction in the cost of the home.

The Subcommittee may want to consider trying this on a demonstration basis in economically depressed areas. It would be a positive step in assisting families to become homeowners and in counteracting the VA's property disposition policy which has had the effect of severely lowering home values.

Appraisal of Foreclosed Properties

Appraisal practices by some FHA and VA offices require appraisers to include foreclosed properties as comparables when evaluating the price of a home. This can cause a devaluation of homes in the entire neighborhood. Like auctions, it also results in the loss of the homeowner's equity which leads to further foreclosures and added losses to government housing portfolios. Lenders in turn become more conservative in loan underwriting to avoid losses resulting from the effects of the appraisal practice.

Our Board of Directors passed policy opposing the use of the sale of any recently foreclosed or distressed property as a comparable in determining an appraisal including homes sold by auction. (Attachment B)

It is vital that alternatives to auctions to sell distressed properties be found and that an appraisal of foreclosed properties not be mandated when assessing the value of homes.

Forbearance

Another approach to the foreclosure problem is to help keep the veteran in his home in the first place. The Veterans Administration in conjunction with lenders may be of assistance by developing a broad program of forbearance to assist homeowners until they regain the ability to make full payment on their homes.

These solutions might include a short term forbearance in the form of a moratorium which could be considered in cases of financial crises. The VA legislation passed last December (P.L. 100-198) calls for greater counseling regarding alternatives to foreclosure and this may be another tool to assist the veteran in retaining his home. This legislation also calls for stricter underwriting procedures, which may prevent loan delinquencies to begin with.

Another possible solution would be to reduce interest rates on loans for veterans who are in financial trouble. This could be done on a case by case basis, coupled with financial consultation. In this manner, help would be made to the veteran before foreclosure occurs. This would be more effective than the Senate's proposal to reduce interest rates on loans made to sell properties already in foreclosure, where the buyer does not have to be a veteran to qualify.

NAHB's Board of Directors passed policy supporting forbearance on FHA and VA home loans. They stressed that homeownership is a cornerstone of our American way of life. An investment in a home represents the biggest asset most families have. Through no personal fault of their own many are unable to keep their mortgage payments current. (Attachment C)

In conclusion, we hope that you will stop all auctions and use of foreclosed property for appraisal purposes as they depress prices and have a detrimental effect on the marketplace. Leasing properties with the option to buy and providing for lender forbearance are better alternatives.

Maximizing Return on Loan Asset Sales

The Committee Print recommends the sale of VA loans with recourse (government guaranty) and without recourse if at least a 90 percent return is received. Our concern with the sale of the government loan portfolios is the overall impact it will have upon the long term economic health of the various federal programs affected. In deciding which assets to sell, careful consideration must be given to assessing the true value of the income stream of the asset being sold. Short-term gain in deficit reduction must be balanced against the long-term loss of the income stream in determining the actual "value" of the asset sale and the long-term implications and loss to the program.

Loan assets sold without a VA guaranty (nonrecourse) may need some form of credit enhancement which can be expensive. A nonrecourse sale presents many problems. The loans being sold are by definition loans made to finance the disposition of properties acquired by the VA because a veteran went into default. By the very nature of their location such properties make capital investors wary. Additionally, the loss of the income stream for the Loan Guaranty Revolving Fund only increases the pressure for additional appropriations.

AREAS OF CONCERN

Reciprocity of Subdivision Approval

Madam Chairwoman, the Department of Housing and Urban Development (HUD) issued a memorandum on March 16, 1988 which states that the VA's certificates of reasonable value (CRVs and

(MCRVs) will no longer be accepted as evidence of subdivision approval by FHA.

FHA and VA have had legislative authority for reciprocity of subdivision approval since 1983. The decision from HUD reverses this long standing policy and is jeopardizing the 1988 building season.

NAHB passed policy urging Congress and the Department of Housing and Urban Development to take steps to immediately end the FHA's policy of conducting additional subdivision reviews and environmental assessment as part of processing applications. (Attachment D)

We are pleased that report language accompanying the FY'89 House HUD Appropriations bill directs the Department to withdraw the March 16 policy change. The report states, "Immediate action on this issue will serve the interest of both the housing industry and America's homebuyers." The House Homeless bill (H.R. 4351) also includes legislation which states that the HUD Secretary "shall consider the issuance by the Administrator of Veterans' Affairs of a certificate of reasonable value for 1 or more properties in a subdivision to be an administrative approval of the entire subdivision." Although Secretary Pierce has delayed full implementation of the policy change to August 1, we continue to believe these restrictions should be rescinded entirely. We urge your cooperation with other Members of Congress in reversing HUD's policy decision.

Direct Approval of Appraisals

Madam Chairwoman, last year's VA Housing Bill provides for direct approval of appraisals by VA lenders. Timely appraisals of property are critical in the new home market and this legislation would substantially shorten the time involved to process VA loans. We have been informed by the VA, however, that regulations which could take as long as a year to process are needed for implementation of the direct appraisal provisions of the law.

Our Board of Directors passed policy endorsing the immediate adoption of direct approval of appraisals by the VA. (Attachment E). We urge you to seek immediate implementation of this program which will be of particular benefit to new homebuying veterans in the marketplace.

Adjustable Rate Mortgages

Madam Chairwoman, we thank you for your effective leadership in passing a pilot program for an adjustable rate mortgage (ARM) in the House of Representatives last year. We regret that this valuable mortgage instrument was dropped in conference when the VA bill passed last December. This ARM was to be patterned after the Department of Housing and Urban Development's ARM, which limits its interest rate increase to 1 percent per year with a cap of 5 percent over the life of the loan. NAHB continues to strongly support authority for the VA to guarantee ARMs. This is a very helpful mortgage instrument, since it could save a veteran about $100 a month on the average VA loan. It

also enables more veterans to qualify in times of high interest rates, as well as allowing veterans a rate decrease without refinancing.

We urge the Congress to support authorization for the VA to offer this type of mortgage instrument, since the VA is the only major market participant without an ARM. As you may be aware, the new Housing Task Force report, "A Decent Place to Live" recommends updating the VA program to include an adjustable rate mortgage. The report emphasizes that an ARM is necessary to make the program fully responsive to market developments.

NAHB would be willing to work with the VA to develop information about the performance of ARMs to address the concerns of veterans groups about the safety and soundness of an adjustable rate mortgage.

CONCLUSION

In conclusion, we hope that careful analysis will be given to retaining the entitlement nature of the VA Home Loan Guaranty Program while trying to streamline it and make it self-sufficient. The VA entitlement has allowed 12.7 million veterans to obtain housing since 1944. Congress and the Administration must continue the responsibility of providing assistance to veterans for the purchase of housing.

Thank you for allowing us to present our views. I would be pleased to respond to any questions you may have.

ATTACHMENT A

May 6-11, 1988
Washington, D.C.

NAHB Resolution

Federal Housing Administration and Veterans Administration Property Auctions

WHEREAS, bulk real estate auctions of foreclosed properties often cause unnecessary devaluation of property values throughout a market; and

WHEREAS, this property devaluation contributes to a downward spiral of additional foreclosures and further property devaluation,

NOW, THEREFORE, BE IT RESOLVED that the National Association of Home Builders urge the Federal Housing Administration and the Veterans Administration to cease bulk property auctions and to develop alternative programs for the disposition and use of foreclosed properties.

BOARD OF DIRECTORS ACTION: APPROVED

ATTACHMENT B

May 6-11, 1988
Washington, D.C.

NAHB Resolution

FHA/VA Appraisals

WHEREAS, appraisal practices by some Federal Housing Administration and Veterans Administration offices which require appraisers to include foreclosed properties as comparables are causing a devaluation of homes in entire neighborhoods;

WHEREAS, this devaluation in many instances results in loss of a home owner's equity, thereby leading to further foreclosures and added losses for the FHA and VA; and

WHEREAS, lenders may become even more conservative in loan underwriting to avoid losses resulting from the effects of this appraisal practice,

NOW, THEREFORE, BE IT RESOLVED that the National Association of Home Builders oppose appraisal practices by the Federal Housing Administration and the Veterans Administration that compel the use of at least one recently foreclosed property as a comparable, and

BE IT FURTHER RESOLVED that NAHB oppose the use of the sale of any recently foreclosed or distressed property as a comparable in determining an appraisal.

BOARD OF DIRECTORS ACTION: APPROVED

ATTACHMENT C

May 6-11, 1988
Washington, D.C.

NAHB Resolution

Temporary Mortgage Assistance

WHEREAS, homeownership is a cornerstone of the American way of life;

WHEREAS, for most American families, investment in a home represents the bulk of their net worth;

WHEREAS, large numbers of home owners, through no personal fault or failure, are unable to keep their mortgage payment current; and

WHEREAS, default problems cause significant losses to the FHA and VA program,

NOW, THEREFORE, BE IT RESOLVED that the Federal Housing Administration and the Veterans Administration, in conjunction with their approved lenders, develop a broad program of forebearance to assist home owners until they regain the ability to make full payment, and thereby permit them to remain in possession of their homes, and

BE IT FURTHER RESOLVED that FHA take all necessary steps to make workable, expand and effectively implement the Temporary Mortgage Assistance Program (TMAP) authorized by Congress.

BOARD OF DIRECTORS ACTION: APPROVED

ATTACHMENT D

May 6-11, 1988
Washington, D.C.

NAHB Resolution

Federal Housing Administration Subdivision Approvals and Acceptance of Veterans Administration Certificates of Reasonable Value

WHEREAS, states and localities across the nation recognize the need to provide a healthy environment and to promote the development of well planned communities;

WHEREAS, the Veterans Administration has decided not to duplicate subdivision reviews and environmental assessments undertaken by states and localities;

WHEREAS, the Veterans Administration has ceased doing any additional subdivision review and environmental assessment as part of processing Certificates of Reasonable Value and Master Certificates of Reasonable Value in new subdivisions; and

WHEREAS, despite this recognition and response by states and localities, the Department of Housing and Urban Development has recently issued a memorandum which will require HUD to review subdivisions which are subject to a VA CRV or MCRV,

NOW, THEREFORE, BE IT RESOLVED that the National Association of Home Builders urge the Department of Housing and Urban Development and Congress to take steps to immediately end the Federal Housing Administration's policy of conducting additional subdivision review and environmental assessment as part of processing applications for the FHA conditional commitments in subdivisions, and

BE IT FURTHER RESOLVED that HUD withdraw its March 16th memorandum rescinding automatic conversion of VA CRV's and MCRV's for new construction.

ATTACHMENT E

May 6-11, 1988
Washington, D.C.

NAHB Resolution

Veterans Administration Approval of Appraisals

WHEREAS, the availability of mortgage loans guaranteed by the Veterans Administration is essential to the home building industry;

WHEREAS, timely appraisals of properties considered for VA financing are a critical factor in the new home market;

WHEREAS, a procedure whereby VA automatic lenders could directly approve appraisals would substantially shorten the time involved to process VA loans;

WHEREAS, VA has the necessary authority and a Congressional mandate to permit automatic lenders to approve appraisals; and

WHEREAS, such a direct approval procedure is essential in light of the reductions in the appraisal personnel employed by the VA,

NOW, THEREFORE, BE IT RESOLVED that the National Association of Home Builders strongly endorse the immediate adoption of a direct approval of appraisals by VA lenders.

BOARD OF DIRECTORS ACTION: APPROVED

UNIVERSITY OF CALIFORNIA, BERKELEY

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STATEMENT OF ROBERT H. EDELSTEIN

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Co-Chairman, Center for Real Estate and Urban Economics
University of California at Berkeley

Before the Subcommittee on Housing and Memorial Affairs
Committee on Veteran Affairs
United States House of Representatives

"Oversight and Solvency of the Veterans Administration
Home Loan Guaranty Program"

June 16, 1988

Madam Chairwoman, and Members of the Subcommittee:

I thank you for the opportunity to come before your Committee to discuss the viability of my proposed Net Shared Equity Loan program. I believe strongly that my proposal can be utilized either alone or jointly with other proposals to enhance the long run fiscal solvency of the Veterans Administration's Loan Guaranty Program. In my earlier testimony of March 17, 1988, I provided a schematic view of my Net Shared Equity Loan proposal. I will now provide a refined version of the Net Shared Equity Loan proposal. I will follow by addressing a set of questions which are likely to surface with regard to my proposal.

NET SHARED EQUITY LOAN PROPOSAL: A REFINED VERSION

In the analysis that follows, first, it is assumed that Congress intends to maintain the benefits and entitlements received by veterans. Second, it is assumed that the fiscal viability and solvency of the loan guaranty program are of paramount concern. Third, it is assumed that the key benefits of the Veterans' Loan Guaranty program, as currently conducted, is the ability of the veteran to finance virtually one-hundred percent of his house purchase.

The Net Shared Equity Loan plan, as outlined in my earlier testimony, provides up to one-hundred financing of home purchases, and requires that upon sale, refinancing or transfer of the property by the veteran that any net equity be shared with the Government. (If there is no net equity buildup, the Veteran owes nothing). The proceeds paid by the veteran to the Government would be placed into a separate Indemnity Trust Fund, which would be used to fund expenses and loan defaults of the program.

INDEMNITY TRUST FUND

The Indemnity Trust Fund would be established as a separate fund for accounting purposes. Existing guaranteed VA loans would be accounted for and maintained outside of the Net Shared Equity Loan program. Funds paid into the Indemnity Trust Fund that are surplus should earn interest income at current Treasury market rates. Similarly, if the Indemnity Trust Fund has a cash flow short fall, for example, because of payouts engendered by defaults, the trust fund should be "charged" market interest on the funds it borrows.

CALIBRATIONS OF NET SHARING RATE

In order that the Indemnity Trust Fund under the Net Shared Equity plan be solvent in the long term, the rate (or per cent) for sharing net equity must be calibrated properly. The following hypothetical example will illustrate how the sharing of equity would work; I will then discuss the calibration of the net equity sharing rate (per cent).

AN EXAMPLE

Assume a veteran finances one-hundred per cent of the purchase of a home with a selling price of $100,000 with a Net Shared Equity loan. For a fixed interest rate, fully-amortized periodic payment 10.5%, 30 year mortgage, the monthly payments would be $914.74. If at the end of seven years the property were sold, and if it were to appreciate at 5% per year net (after all commissions, expenses, fees and other selling costs), then the net value of the appreciation would be $40,710.04. Under our schema, assuming a 5% net equity sharing rate, the veteran would pay $2,035.50 to the VA.

DETERMINING THE NET EQUITY SHARING RATE

The computation of the appropriate net equity sharing rate that will over the long run engender a solvent Indemnity Trust Fund is dependent upon six sets of variables:

1. The probability that a loan may default.
2. The costs of a default, conditional upon the default. This would include all holding expenses and costs during the default as well as a selling commission and other liquidation expenses, and so forth.
3. The property value net appreciation rate that is assumed.
4. The average loan amounts issued.

5. The assumed interest rate for borrowing from and lending to the Indemnity Trust Fund.
6. The distributions of defaults over time as well as the distributions of loan repayments over time must be assumed.

In appendix A, I show how one would determine the net equity sharing rate that will engender long run solvency. Using the formula developed, and simulating the results on a computer, one can determine under various assumptions what will be the appropiate net equity sharing rate to charge veterans. The results of these simulations suggest that using the assumptions that are consistent with VA loan historical experience, and building in a safety margin for error, the net rate for sharing equity need not be as much as five per cent of the average net equity buildup.

NET SHARED EQUITY LOAN AND OTHER PROPOSALS

It is important to note that the indemnity trust fund-net equity sharing schema is not necessarily to be used exclusively of other loan guaranty programs. It can be used jointly as an alternative to other plans, though, I believe, it is superior to other currently existing or espoused alternatives. In general, the Net Shared Equity Loan plan reduces the monthly veteran payments and reduces the loan balance that will be due at any point in time in the future. By doing this, Net Shared Equity Loans reduce the probability of default and ultimate foreclosure under the VA loan program. In the long run the program should not require government subsidy, and, therefore, will not be a burden to the taxpayer. Finally, the program provides that the "actual" beneficiaries of the program (i.e., those who gain through property value appreciation in the Veteran Loan Program) share the cost burden of the program. Simultaneously, veterans who do not gain by use of the program, do not pay.

COMPARING THE NET SHARED EQUITY LOAN PROGRAM WITH THE VETERAN HOME MORTGAGE INDEMNITY FUND PLAN

Tables 1 and 2 compare the costs of the Net Shared Equity Loan program with the proposed Veteran Home Loan Mortgage Indemnity Fund program. Table 1 shows how a $100,000 fully-financed home purchase with a 10.5 per cent, 30 year mortgage would be conducted under each program. The monthly payments under the Net Equity Sharing Program Loan would be $11.43 less; and if the loan were paid off in seven years, the outstanding loan balance under the Net Shared Equity Loan program would also be $1,189.34 less. In essence, the Net Shared Equity Loans would cost a veteran less each month and at any point in time would have a lower loan balance than loans taken out under the Home Loan Mortgage Indemnity Fund Program.

Table 2 shows how this would affect the veteran in terms of net benefit he would "walk away with" at the end of the sale of the property at seven years. As one can see from this table, the net result is that the veteran is likely to end up with more money under the Net Shared Equity Loan program than under the proposed Home Loan Mortgage Indemnity Fund program. Furthermore, this calculation does not take into account that the Veterans' Administration and (ultimately the taxpayer) would need to pay an additional $750 on behalf of the veteran under the Veteran Home Mortgage Loan Indemnity Fund Program (i.e., the three-quarters of a per cent point for the assumed $100,000 loan).

Table 1

Hypothetical example of the comparative cost to the Veteran:

Net Shared Equity Loan Program

versus

Veteran Home Mortgage Fund-Loan Program

ASSUME (1) $100,000 fair market value home purchase, 100% financed;

(2) 30 year 10 1/2% amortized financing; and

(3) Net rate of equity build-up for home (after all selling expenses) is 5% per annum.

	(1) Net Shared Equity Loan	(2) Indemnity Fund-Loan	(3) Difference [(2)-(1)]
Gross Loan Amount to Veterans	$100,000	$101,250 (including 1.25 pts)	$1,250
Monthly Payment (30 year loan @10.5%)	$914.74	$926.17	$11.43
Loan Balance at the end of seventh year	$95,100.25	$96,289.59	$1,189.34

TABLE 2:

Gains to Veteran From Loan Program: Net Shared Equity Loan Program versus Veteran Home Mortgage Loan Program

ASSUME (1) seven years until sale of home;

(2) property value appreciates (net of selling expenses) at 5% per annum:

(3) sharing rate is 5% of net equity buildup

NET SHARED EQUITY LOAN PROGRAM		INDEMNITY FUND-POINTS LOAN PROGRAM
$140,710.04	Net value of home end of 7th yr.*	$140,710.04
-$95,100.50	Loan balance at the end of 7th year	-$96,289.59
-$2,035.50	Net Equity Shared (5% of $40,710.04)**	
	Difference in monthly payments $11.93 x 84 month	-$960.12
$43,574.29	Net available to Veterans after sale	$43,460.33

* 100,000 x (1.05) =140,710.04

** (140,710.04-100,000) x .05=2,035.50

Important Questions and Answers About the Net Equity Sharing Proposal

Since the Net Shared Equity Loan proposal appears to be substantially and substantively different than the existing V.A. Loan Guaranty program, it should not be surprising that questions arise and clarifications may be required. Let me address what appear to be the most frequently recurring issues and questions.

1. Will the new program be an administrative nightmare?

This concern is unrealistic. First, proper loan program administration -- for any loan program -- requires that the Veterans' Administration and the private sector lenders keep track of who the currrent borrower is. Second, it would be a simple matter to compute the amount of net shared equity due from a sale; the computation requires a copy of the HUD-1 RESPA form (which is a statement disclosing settlement costs) and the IRS Federal tax form 2119, Computations for the Sale of Principal Residence (which is required for people who sell their principal residence). From these two documents, one would be able to determine the net equity accumulated in the property and, therefore, the amount that would be "rebated" on sale to the VA Loan Guaranty program. This procedure would not require an extensive evaluation of individual tax returns. Furthermore, in order to assure that a property is not sold without the VA obtaining its portion of the net equity build-up, when the loan is originally recorded, it would be easy to require a sale contingent lien against the property.

2. Is there a potential for a Federal tax liability under this net equity sharing plan?

Most sales of homes where there is an equity build-up do not result in an immediate tax obligation. Usually people purchase another home which is more expensive than the one they have sold, which causes the Federal capital gains tax to be deferred indefinitely. In any case, if the rebated payment under the Net Shared Equity Loan program to the VA were considered a fee or expense incurred by the seller, the basis for the capital gains tax would be reduced dollar for dollar.

3. Does the program provide "any" benefit to veterans for participating in the program?

A veteran who borrows money under the Net Shared Equity Loan program would eventually rebate money to the VA, based on a portion of his gain; but would forego, presumably, the points and fees that he would pay under the existing or proposed loan programs. As I have shown above (see Tables 1 and 2), the net shared equity loan is likely to save the veteran money on his monthly payments as well as his loan balance.

4. Would the Net Equity Sharing Proposal Plan unfairly penalize those veterans who increase the value of their homes through "sweat equity"?

To the extent that an individual improves his property, he will be sharing "sweat equity" (but costs of materials and labor would change the Veteran's basis and would not be shared with VA ex post). The fact that veteran-borrowers can obtain home ownership with a "nothing down" purchase is the key benefit of the program. This type of loan gives the veteran a chance to accumulate equity without risking any money of his own.

5. Will financially secure borrowers and those living in more prosperous areas avoid the possibility of surrendering a portion of their equity and use alternative financing?

In the final analysis, this is not a real problem. From the experience over the last 25 or 30 years, it is unclear whether anyone can predict accurately that they will be among the prosperous. The question of moral hazard (i.e., people opting out of the program because they believe they can achieve higher than average rates of appreciation on their property) is, I believe, contrary to the proven facts and capabilities of mortgage insurers, lenders and borrowers. The Net Shared Equity Loan program, in fact, diversifies against the problem of non-market predictability.

Conclusion

The proposed Net Shared Equity Loan program will provide long run fiscal solvency for the Veterans' Administration Loan Guaranty program. It should not require over the long haul any subsidy from tax-payers. The loans will require that borrowers who have significant property appreciation return a small proportion of that gain to the VA in order to pay for the program costs (i.e., defaults and other expenses). Typically, veterans will "end up" with as large a cash benefit under the Net Shared Equity loan program as they would under plans that require points up-front.

APPENDIX A

Computation of Appropriate Net Sharing Rate

This appendix demonstrates how one computes the net equity sharing rate that is needed to make the Net Shared Equity Loan program solvent over the long run. Equation 1-A is the cost of the loan that goes into default.

Where P = the probability of default and

Cost = the net costs of a default to the VA.

r = the appropriate discount rate

$$E\,[\text{Cost}] = P \cdot \text{Cost} \cdot (1+r)^{-t} \qquad (1A)$$

Equation 2-A is the expected Gain for a veteran because of property value appreciation (for a property that does not default).

$$E\,[\text{Gain}] = (1-P) \cdot (1+g)^{T} \cdot (1+r)^{-T} \cdot \text{Loan} \qquad (2A)$$

Where, 1 - P = the probability that a property will not default.

g = the net appreciation rate

Loan = the loan amount assumed to be equal to 100%

To find the appropriate net equity sharing rate X, one needs to equate the expected costs of default with the expected appreciation times X, the net equity sharing rate. This is done in equation 3-A.

$$\text{Find } X \text{ such that } E\,[\text{Cost}] = X \cdot E\,[\text{Gain}] \qquad (3A)$$

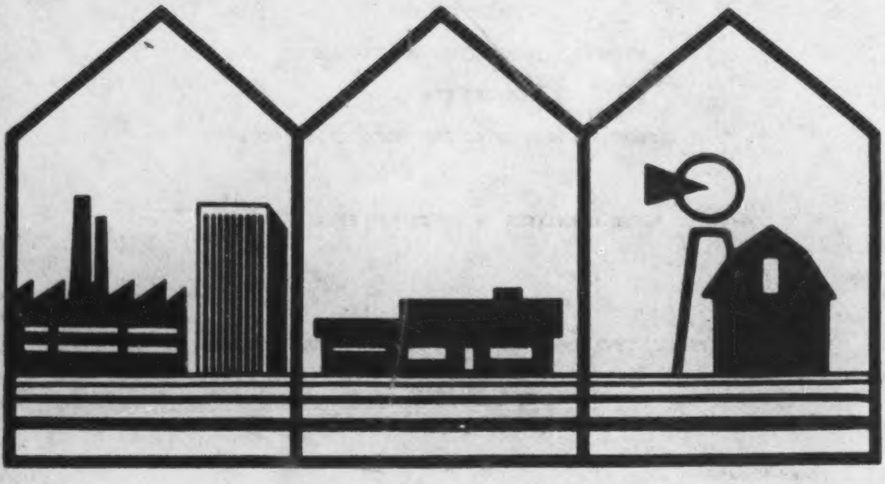
$$P \cdot \text{Cost}(1+r)^{-t} = X \cdot (1-P) \cdot (1+g)^{T} \cdot (1+r)^{-T} \cdot \text{Loan}$$

Simplifying equation 3-A and solving for X, one obtains 4-A.

Simplifying

$$X = (P/1-P)\cdot(1+r)^{T-t}\cdot(1+g)^{-T}\cdot[\mathrm{Cost}/\mathrm{Loan}] \qquad (4A)$$

Equation 4-A can be used to solve for the appropriate X's, for various assumed values for the probability of default, discount rates, periods until the property sells, loan values and costs of defaults.



Statement of the
NATIONAL ASSOCIATION OF REALTORS®
THE WORLD'S LARGEST TRADE ASSOCIATION

TO: SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS OF THE HOUSE VETERANS' AFFAIRS COMMITTEE

ON: VA HOME LOAN GUARANTY PROGRAM

BY: BOB J. MUFFLEY, 1988 CHAIRMAN, GOVERNMENT MORTGAGE PROGRAMS SUBCOMMITTEE, REAL ESTATE FINANCE COMMITTEE

DATE: JUNE 16, 1988

STATEMENT OF THE
NATIONAL ASSOCIATION OF REALTORS®
BEFORE THE
SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS
OF THE
HOUSE COMMITTEE ON VETERANS' AFFAIRS

BY

BOB J. MUFFLEY

CHAIRMAN, GOVERNMENT MORTGAGE PROGRAMS SUBCOMMITTEE

JUNE 16, 1988

INTRODUCTION

Madam Chairwoman, Members of the Subcommittee, my name is Bob J. Muffley. I am a REALTOR® from Gooding, Idaho and the 1988 Chairman of the Government Mortgage Programs Subcommittee of the NATIONAL ASSOCIATION OF REALTORS®. On behalf of the more than 800,000 members of our Association, I would like to thank you and the Members of the Subcommittee for your commitment to promoting homeownership opportunities for our nation's veterans - and for this opportunity to participate in your evaluation of the Veterans Administration's (VA) Home Loan Guaranty Program.

Madam Chairwoman, the NATIONAL ASSOCIATION OF REALTORS® believes that the VA Home Loan Guaranty Program is an effective and worthwhile Federal program. The Veterans Administration's offer of a fully guaranteed mortgage loan, with no downpayment requirement has, for over forty-four years, enabled more than twelve million American veterans to purchase and maintain a home. This is an impressive record of success, Madam Chairwoman, and the NATIONAL ASSOCIATION OF REALTORS® is very proud to be able to participate in today's review of such a successful program.

The NATIONAL ASSOCIATION OF REALTORS® believes that the continued viability of the VA Home Loan Guaranty Program should be the ultimate goal of any alterations that the Subcommittee deems necessary to make. We additionally believe that, as the Subcommittee evaluates the VA Home Loan Guaranty Program, it should pursue the following goals:

- o Improve the homeownership benefits provided to veterans by the VA Home Loan Guaranty Program.
- o Lower the costs of administration and default whose increasing burden threatens to undermine the integrity of the entire VA Home Loan Guaranty Program.

The following testimony details the comments of the NATIONAL ASSOCIATION OF REALTORS® on the legislative proposals affecting the VA Home Loan Guaranty Program, including the Subcommittee's "committee prints", dated May 23, and May 25, 1988 and the concept of a Shared Equity Program for the VA Home Loan Guaranty Program. This testimony also reviews several legislative and regulatory recommendations, developed by the NATIONAL ASSOCIATION OF REALTORS®, whose goal is to enhance both the benefits and the viability of the VA program.

I. COMMITTEE PRINT

Indemnity Fund - The NATIONAL ASSOCIATION OF REALTORS® understands that the goal of establishing a VA Mortgage Indemnity Fund is to revitalize the funding of the VA Home Loan Guaranty Program while simultaneously providing increased financial protection for veterans in the event of default on their VA-guaranteed mortgages and foreclosure on their homes. The NATIONAL ASSOCIATION OF REALTORS® supports each of these goals individually. We strongly support efforts that strive for the goal that a veteran not lose his or her home. We do, however, have serious reservations concerning the specific "Indemnity Fund" proposal in that it potentially offers only a cushion to a veteran who experiences a default and foreclosure, and in fact, may make default and foreclosure a more acceptable result for a veteran delinquent on his or her loan.

The indemnity fund proposal also presents other problems of concern to the NATIONAL ASSOCIATION OF REALTORS®:

> Indemnity Fee - The NATIONAL ASSOCIATION OF REALTORS® opposes any legislative proposal that would increase the amount of up-front fees that a veteran would be required to pay in order to obtain a VA-guaranteed mortgage. The proposed indemnity fee, 1.25 percent of the loan amount, represents a slight, but important increase over the one percent "funding fee" presently charged. Even though the legislative proposal envisions a veteran being able to finance the amount of this "indemnity fee" we do not believe that veterans should be charged increased fees in order to use this entitlement program. Further, such an up-front fee increase will affect the ability of veterans to afford a home purchase utilizing a VA guaranty, and thus, reduce the number of veterans able to afford to utilize the program.
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> Supplemental Funding - The "committee print" proposes that, in addition to the 1.25 percent indemnity fee paid by the veteran, the Federal government will credit .25 percent of the VA loan amount to the VA indemnity fund during the first three fiscal years after the loan is originated, resulting in a two percent, per loan, total income to the VA

indemnity fund. Presently, the Congress appropriates supplemental funding whenever shortfalls are experienced within the VA loan guaranty revolving fund. The NATIONAL ASSOCIATION OF REALTORS® has approved no policy as to which funding mechanism is more appropriate, but believes that the issue that must be resolved is whether it is preferable for Congress, when necessary, to appropriate funds for the program as is the current practice, or whether supplemental funding for the VA program should be stockpiled within the program itself as provided in the proposed legislation. We would request that the Subcommittee compare and evaluate the forecasted funding levels that would be requested/stockpiled for the VA home loan guaranty program under each method, and to share that comparison publicly.

Use of Funds - We additionally understand that under the proposal, the VA would be authorized to invest portions of its stockpiled funds in order to increase earnings. The NATIONAL ASSOCIATION OF REALTORS® believes that if this approach is adopted, then the legislation should clearly stipulate that whether earned or accumulated under the proposed indemnity program, all funds, should be used solely to cover the costs and obligations of the VA Mortgage Indemnity Program.

Loan Guaranty Revolving Fund - The indemnity fee proposal, as envisioned, is to be applied to, and used for, VA loans guaranteed after the effective date of the legislation. The one percent funding fee presently being paid by veterans into the VA Loan Guaranty revolving fund would be discontinued as of the effective date as well. While the primary funding and source of income has been eliminated, however the loan guaranty revolving fund must and will be continued to pay claims based on the loans that it has guaranteed. In the absence of its primary source of income, the NATIONAL ASSOCIATION OF REALTORS® is concerned that the Congress will have to appropriate substantial amounts to the loan guaranty revolving fund just to keep it alive long enough to fulfill its present obligations. The NATIONAL ASSOCIATION OF REALTORS® respectfully requests that the Subcommittee evaluate the cost of transition from a loan guaranty revolving fund to an indemnity fund.

Role of Indemnity - The NATIONAL ASSOCIATION OF REALTORS® questions the appropriateness of providing indemnity to a veteran upon the purchase of his or her home. It is our strong belief that veterans — indeed all homeowners — should, in the face of default and foreclosure, be provided every possible opportunity to maintain their home. Aside from the love of "home", a key motivation for a homebuyer to maintain his or her home purchase is the degree of personal liability for the loan. Thus, it would appear that the removal of personal liability (i.e. the establishment of indemnity) for the mortgage loan will present an even greater potential risk to the VA Home Loan Guaranty Program itself -

because it could result in veterans becoming more willing to abandon their property in the event of a default. The NATIONAL ASSOCIATION OF REALTORS® respectfully requests that before pursuing this aspect of the "committee print" proposal, the Subcommittee evaluate this concept in light of the potential increases in the rate of defaults and foreclosure, and the result of such an increase on the viability of the VA home loan guaranty program.

The NATIONAL ASSOCIATION OF REALTORS® is also concerned with other provisions contained within the Subcommittee's draft proposal, as follows:

Sale of Vendee Loans - The proposed bill would authorize the VA to sell vendee loans, without recourse, provided that the purchase price is at least 90 percent of the unpaid loan balance. It would also permit the VA to continue to sell its vendee loans with recourse. The NATIONAL ASSOCIATION OF REALTORS® has long sought to assure that the sale of VA vendee loans does not result in the "dumping" of valuable VA assets. Thus, the NATIONAL ASSOCIATION OF REALTORS® is pleased to support the proposed bill's establishment of a meaningful minimum threshold for the sale of VA vendee loans without recourse and we applaud the Subcommittee's creativity in developing this proposal.

Entitlement Restoration - The NATIONAL ASSOCIATION OF REALTORS® strongly supports the provision of the proposed bill that would restore a veteran's VA home loan entitlement upon repayment of the VA mortgage loan. Presently, veterans are burdened with the requirement that entitlement may only be restored when two conditions are met: (1) the loan is repaid and (2) the property is sold. We believe that the current law unnecessarily limits the ability of veterans to utilize the benefits of the VA program, especially when one consider that complete repayment of the VA-guaranteed mortgage represents the termination of the VA's guaranty and the benefits emanating from that guaranty. The NATIONAL ASSOCIATION OF REALTORS® wholeheartedly supports this provision.

Disposal of VA Property - As the members of the Subcommittee are aware, the NATIONAL ASSOCIATION OF REALTORS® has opposed continued VA attempts to auction large numbers of its acquired properties. It should be noted, however, that the NATIONAL ASSOCIATION OF REALTORS® does not categorically object to the auction method of selling properties. Rather, we believe that the Veterans Administration needs to improve the performance of its property disposition responsibilities. Stated simply, the NATIONAL ASSOCIATION OF REALTORS® would not object to the auction of VA's acquired properties if it was conducted as part of a comprehensive and intelligent property disposition program.

The NATIONAL ASSOCIATION OF REALTORS® respectfully recommends that the language of the proposed bill pertaining to the disposition of VA-acquired properties should be moderated so as to direct the VA to develop an effective property disposition program utilizing the many resources at its disposal. For example:

- o VA should, in conjunction with the local real estate industry, develop a property disposition strategy that develops and utilizes innovative, market-oriented, property disposition methods.

- o VA should improve its property management responsibilities. An effective property disposition program requires effective property management techniques, either performed by the VA or contracted to a property management professional to avoid damage to a acquired properties that results in diminished sales prices.

- o VA's property disposition program should be conducted on a regular basis. It should be unacceptable practice to accumulate large numbers of properties and then "dump" them when either the cost of management becomes unbearable or additional funding for the VA program is required.

- o A properly timed, promoted, marketed, and conducted real estate auction can be a useful mechanism to sell acquired properties. Such a plan should, however, discourage the sale of large numbers of properties on the same day, and should be scheduled to complement, not undermine, other local efforts to set up an effective property disposition program.

Effective Date - The "committee print" would require the Veterans Administration to implement the provisions of this act upon the first day of the second month following enactment of this bill - a time period that could be as short as thirty-two days. The NATIONAL ASSOCIATION OF REALTORS® respectfully requests that the indemnity fund proposal, if enacted, be provided a greater lead-time before becoming effective. The goal of such an effective date should be to provide ample opportunity for information concerning the new program to be disseminated and understood.

II. Shared Equity Appreciation Program

The NATIONAL ASSOCIATION OF REALTORS® has not had the opportunity to consider or approve policy on the proposal before the Subcommittee to create a shared equity appreciation program under the VA Home Loan Guaranty Program; however, we do wish to express several concerns.

The essence of the provision is to authorize, the VA to receive a portion to the appreciation of a veteran's home, at the time a home with a VA-guaranteed mortgage is sold.

It is apparent that this proposal was intended to serve as the vehicle to provide increased revenue to the VA Home Loan Guaranty Fund. At first blush, the proposal appears to achieve that goal; however, a closer review reveals several potentially serious threats to the benefits of homeownership for any veteran who elects this option. First, although the proposal is envisioned as a complement to the standard VA program, it fails to provide any benefit to a veteran for participating in the program. Instead, the program generates a monetary negative in that it establishes, in effect, a Federal tax upon the sale of a property with a VA-guaranteed mortgage. Second, and more significantly, the amount charged by such a tax would vary between cities and regions - and would require VA homeowners in regions experiencing greater appreciation to pay more than VA homeowners in other regions. Finally, the plan unfairly penalizes those veterans who increase the value and/or sales price of their homes through the effort of "sweat equity" and may actually discourage such efforts.

The NATIONAL ASSOCIATION OF REALTORS® strongly urges the Subcommittee to reject any such proposal to tax, or otherwise draw upon, the appreciation of a veteran's home.

III. REALTOR® Recommendations

The NATIONAL ASSOCIATION OF REALTORS® has recently conducted its own evaluation of the VA home loan guaranty program. The goal of our evaluation was to examine the actual operations of the VA program with which our members conduct much of their business, and recommend changes that will enhance both the quality of the benefits provided by the program and the ability of the VA to provide those benefits. As always, we will be pleased to provide any additional information about these proposals that the members of the Subcommittee may desire.

This section identifies both the findings of the NATIONAL ASSOCIATION OF REALTORS®' evaluation and details several recommendations for improving the VA Home Loan Guaranty Program.

STAFFING:

The NATIONAL ASSOCIATION OF REALTORS® notes that inadequate staffing in the regional VA offices has, during periods of low interest rates and high loan demand, contributed to the delay of processing of mortgage applications. In some cases, the delay has been greater than 120 days, which is, in our view, an unacceptable timeframe. Thus, we recommend that the VA be authorized to contract out loan processing and underwriting activities to private entities during periods of high loan volume. The NATIONAL ASSOCIATION OF REALTORS® supports VA's ongoing efforts to delegate processing and underwriting authorities to mortgage lenders. Despite the most valiant efforts, however, it is our experience that VA can still be overwhelmed by the amount of loans that are sent to the VA for approval. Thus, the NATIONAL ASSOCIATION OF REALTORS® believes that the staffing level of the VA regional offices should be increased, and that the VA should be authorized, during periods of especially high volume, to contract out its processing and underwriting authorities.

RENTAL OF VA-ACQUIRED PROPERTIES:

The NATIONAL ASSOCIATION OF REALTORS® notes with interest a proposal previously discussed by this Subcommittee to authorize the VA to rent certain foreclosed properties from its inventory until they can be sold at a better price. The NATIONAL ASSOCIATION OF REALTORS® would support a rental option for those VA-acquired properties provided that two conditions are met: First, that the VA has first attempted to sell the property through a comprehensive and intelligent property disposition program and, second, that despite all sales efforts, the property remains unsold for a reasonable period of time. The specific length of a "reasonable period of time" should be determined based on the needs and conditions of specific state and local markets.

AVOIDING FORECLOSURE:

The NAR believes that the VA should consider and make more frequent use of the voluntary deed conveyance mechanism as a more reasonable and effective alternative to its standard foreclosure procedures. As we are all too painfully aware, while foreclosure may be a necessary result following default, it can also do irreparable damage to a veteran's credit standing, not to mention leaving him or her in substantial debt. Rather than taking this drastic action, the NATIONAL ASSOCIATION OF REALTORS® recommends the voluntary deep conveyance alternative as a better alternative for two reasons. First, the VA avoids the lengthy and costly process involved in foreclosure because the veteran relinquishes all right and title to the property to the lender in lieu of foreclosure. Second, shortening the process allows the VA to acquire and resell the property on a more expeditious basis.

EXPEDITIOUS LOAN PROCESSING:

The NATIONAL ASSOCIATION OF REALTORS® recommends that in order to promote expeditious processing of loans submitted to the VA for approval, the VA should be authorized to create an incentive program for agency staff and officials. The NATIONAL ASSOCIATION OF REALTORS® believes that the goal of quickening the loan approval process can be pursued without compromising the quality of VA's underwriting responsibilities.

DISPOSITION OF ACQUIRED PROPERTIES:

The NATIONAL ASSOCIATION OF REALTORS® notes that VA's present procedures require a ten day waiting period between the time that an acquired property is listed for sale and offers will be considered. As a result, many REALTORS® are reluctant to participate in the bidding process for VA properties. To encourage participation, the NATIONAL ASSOCIATION OF REALTORS® recommends that VA eliminate the waiting period and instead open all bids upon receipt and negotiate the best offer. The NATIONAL ASSOCIATION OF REALTORS® recommends additionally that cash offers for a VA-acquired property should given first consideration.

The NATIONAL ASSOCIATION OF REALTORS® notes that properties acquired by the VA may require repair. The NATIONAL ASSOCIATION OF REALTORS® believes that an effort to make such repairs, which can often be completed at minimal expense, can dramatically enhance the salability of such a property. We note that a potential buyer considering a damaged property may, in his or her own estimation, over-price the cost and effort of vital improvements, and thus, pass over the property. We believe that the VA can enhance its re-sale capabilities by performing a cost-benefit analysis and appraisal of every property acquired with the goal of determining how best to maximize the sales price. The VA should be encouraged to make such repairs.

The NATIONAL ASSOCIATION OF REALTORS® additionally suggests that the VA utilize an effective property disposition technique called "super sales". The "super sale" technique, which is currently and successfully being used by the Federal Housing Administration (FHA), involves aggressive marketing techniques to promote a day of open-houses of inventoried properties. We believe that such promotion and access to VA properties is vital to a swift, and well-priced sale.

The NATIONAL ASSOCIATION OF REALTORS® recommends that VA be authorized to use exclusive listings for the sale of acquired properties in rural areas and/or towns with populations of 10,000 or less. We envision that under such a program the VA would chose real estate brokers on a competitive bid basis.

Additionally, the NATIONAL ASSOCIATION OF REALTORS® believes that VA can further increase the saleability of its acquired properties by liberalizing the underwriting criteria for VA-vendee loan financing.

SOLVENCY OF THE LOAN GUARANTY REVOLVING FUND:

The NATIONAL ASSOCIATION OF REALTORS® notes that in recent years the Congress has appropriated only very small sums, ($1 million in fiscal year 1988) to the VA Direct Loan Program, which is presently used to provide limited housing assistance for disabled veterans. The NATIONAL ASSOCIATION OF REALTORS® believes that the Direct Loan Program offers a potentially valuable source of income for the Loan Guaranty Revolving Fund. The NATIONAL ASSOCIATION OF REALTORS® respectfully recommends that the authorization for this program be enhanced to permit its use in locales where VA-guaranteed financing is not presently available, and that the appropriation level for the program should be increased to enable it to meet this objective. Additionally, the Direct Loan Program should be specifically exempted from present Executive branch directives that require the Federal agencies to dispose of their assets. The NATIONAL ASSOCIATION OF REALTORS® believes that the VA program would benefit from maintaining the assets of a revitalized direct loan program.

CONCLUSION

Madam Chairwoman, the NATIONAL ASSOCIATION OF REALTORS® strongly supports the Veterans Administration Home Loan Guaranty Program and looks forward to this Subcommittee's leadership and commitment to homeownership opportunities for veterans. The NATIONAL ASSOCIATION OF REALTORS® would be pleased to provide any additional information that you, the other members of the Subcommittee, or your staff may need.

Thank you again for this opportunity to testify. I will be happy to answer your questions.

TO: Subcommittee on Housing and Memorial Affairs
Oversight and Legislative Proposal Hearing
June 16, 1988 at 10:00 A.M.
Cannon House Office Building - Room 334

From: Larry W. Latham, CEO/President
Larry Latham Auctioneers

Re: Comments on Discussion Draft dated May 23, 1988
"A bill to amend title 38, United States Code, with
respect to the Veterans' Housing Loan Program

I am Chief Executive Officer of Larry Latham Auctioneers, a firm which auctions the largest number of single family homes annually in the United States. I am a real estate broker in several states. I have previously been a home builder; and, in fact, I constructed Veterans Administration homes in my home area of Northern Alabama prior to entering the auction business in the late 1970's. Through a nationwide competitive bidding process my company was awarded and now holds the auction contract with the Veterans Administration. We have been working with the VA across the country since early 1985. In addition to VA properties, my firm has also marketed for auction sale HUD, Fannie Mae and Farmers Home Administration properties, among others.

Because of the comprehensive background with the Veterans Administration and its housing problems, as well as my expertise with the effectiveness of the auction sales tool for disposition of government-owned real estate. I am regarded by many as the leading authority on government auctions. In attaining this experience level, I have collected a wealth of factual data regarding the auction of single family homes.

Let me say at the onset, I am very supportive of any methods that are designed to prevent the necessity for the foreclosure process. I have spent much time in distressed metropolitan areas such as Houston, and I would like to see those cities regain their stature as communities rich with people filling the neighborhoods and the vacant housing. As you probably know, homes listed at $80,000 just one or two years ago may only sell for one-half that price today; and, there are many miles of nearly vacant neighborhoods.

I applaud you for tackling this problem with your proposed legislation. However, I would like to dispel the findings of Congress on the policy of using auctions for disposing of foreclosed real estate.

I think that you will agree that Americans are the most competitive people in the world, and auctions create urgency and competition. The auction method of real estate sales is one of the best ways to reach the buying public in a cost-effective manner. It offers sales flexibility, strong buyer attraction and a positive sales environment. Auction marketing can reach even hard-to-reach targeted buyers, and can bring those buyers to market.

The Veterans Administration auctions have generated thousands of successful bidders who would never have bought a VA house under normal conditions. The fact is that most Americans are still unaware that they can buy an inventoried VA home without having been a veteran. Our promotional material educates real estate buyers to the fact that they can and should be looking to the VA as a source for their next home. In fact, the long-term interest of the loan housing guaranty program has been tremendously helped by the use of auctions.

The properties that the VA has put on the auction block are properties that have been on the market in most cases for over one year. Most of the properties are in an unlivable condition and many properties have been vandalized. Some of the properties are in parts of the city in which the managing broker will not or has not checked on the property for over six months.

In many parts of the country, such as Houston and Denver, the VA inventory is increasing much faster than sales via the conventional method can counter. Each real estate broker has had an opportunity to sell these properties through a one-on-one listing. But the properties do not sell.

During the time that these VA properties are listed for sale, they continue to incur expenses to the agency, and ultimately to the taxpayers. There are real estate taxes and management broker fees to be paid. Vandalism continues. The value of the homes as assets for the United States taxpayers plunges steadily downward.

When it is clear the properties will not sell any other way, they then become eligible for consideration for the auction marketing process. As noted above, they average over 12 months on the conventional market. The oldest, and usually most damaged properties are those selected for auction first.

Many properties that go to auction are vandalized or burned out. I have seen homes in which the inside walls have been knocked out and all of the electrical wiring has been pulled from the house. I have seen properties in which the air conditioning ducts and even the brick on the outside of the house has been torn away from the house. I have actually auctioned houses which have been burned out on the inside and the appraisal at the time of the sale was the same as it had been a year previous when the property was in excellent condition . When looking at some of these auction prices, they can be made to appear low, but overall auction prices are actually much higher because the list price may not have been valid. Even with properties in this kind of major disrepair, the VA does not usually reduce their appraisal on the properties. The VA does not have the staff to implement updating procedures on its inventoried properties, even though the agency recognizes the unreliable nature of many of the older appraisals.

Traditionally, in the real estate industry, appraisals are used as the major criteria to determine the value of a property, both for pricing purposes and for obtaining financing. There is an underlying assumption that the appraisal accurately reflects the market in which that property is located and the condition of the property. However, this basic and critical assumption breaks down where an appraisal becomes quickly antiquated by both the fluctuations of the economy and the instances of vandalism of empty homes as has happened in many areas in recent years. Not only does an out-dated appraisal not reflect the true market value of a property -- it also can cause the making of unsound business decisions regarding the disposal of a piece of real estate. When the listing price is set based on such an appraisal, the seller is deceiving itself and probably discouraging its market from ever purchasing that property.

The Congressional findings section alleges that "the long term interests of the housing loan guaranty program...are damaged by the use of auctions since a higher price could be obtained for such real property by selling it through conventional methods...." As we have shown, that statement is erroneous at best. To summarize the facts:

- The longer a property stays on the market, the more vandalism occurs to that property; and, therefore, the final sales price decreases.
- Conventional methods of selling property are not working. This is proven by the fact that the inventories of VA properties are growing - not decreasing -- despite record numbers of conventional sales.
- In many parts of the country the real estate market has not bottomed out; and, therefore, holding the houses costs the taxpayers and the consumers of this country vast amounts of money.
- Many of the good properties that go to auction bring tremendous prices as an analysis of our recent Illinois VA auction will show.

Latham Auctioneers successfully auctioned 305 properties in a three day auction on April 29, 30 and May 1, 1988. Properties were scattered throughout the State with most located in Chicago.

This auction was hailed as one of the most successful auctions ever held in the State of Illinois. It produced 7.2 million dollars for the VA Loan Guaranty Fund. Over 3,000 people attended the auction with almost 200 participating brokers.

305 of the 327 properties were sold for a sales rate of 93.2% :

1 property sold for 500% or over of list price
1 property sold for 300% or over of list price
12 properties sold for 150% or over of list price
48 properties sold for 100% or over of list price
22 properties sold for 90% or over of list price
37 properties sold for 80% or over of list price
57 properties sold for 70% or over of list price
305 properties sold for more than the minimum

The overall sales percentage was 77.8% of list price despite the fact that most of the properties had been on the market for over one year. Total list price for the 305 properties totaled 9.3 million. The overall auction sales price totaled 7.2 million.

I do not believe that you will find any Loan Guaranty Officers or any Directors of the Regional Offices who are unhappy with the auction method of selling property. On the contrary, they have been extremely happy with the auction method of disposition and with the prices that their properties have brought in past auctions. Mr. Samuel Holmes, Director of the Veterans Administration Regional Office in Chicago said, "The auction process of selling these homes has proved outstandingly successful."

The auction method of marketing properties gives a true market value. Some properties sell for well above 100% of their list prices and others for much less. But these latter properties are usually those that have been on the market for a long time and are in poor condition.

The VA auctions often attract thousands of people. These are potential buyers of the very properties that the VA could not sell otherwise. An intensive 3-4 week marketing program is conducted prior to the auction to interest bidders. The properties are marketed as a group and individually, and the auction hotline receives thousands of inquiry telephone calls.

The 1,000 or more people bidding on the auction properties represent a true market -- regardless of the appraisals in the VA files. These people have seen the properties. They know the condition of each and have researched the taxes. They have talked to neighbors and have evaluated the locations of the properties. They have comparison shopped. They have done their homework and come to bid at the auction with an understanding of what each property is worth. They are the best judge of VA property values.

Significantly, the VA auction bidders are cash buyers. There is a critical distinction between the cash value and the financed value of a property. Our experience has proven repeatedly that when a property is offered for cash only, whether in one-on-one sales or by auction, the true market value of that property will be lower than that of a property offered with financing. We bring cash buyers to the VA auctions. The VA does not want to re-guarantee the auction properties or make direct loans on them. The agency does not ever want these properties back in inventory. The only way that these properties are marketed for auction is for cash sales. The VA needs these cash dollars to put back into the revolving fund to provide more loan guarantees for veterans. The auction method of real estate sales allows the VA to accomplish this goal quickly and economically.

Between the people attending the auction who are offering cash for the properties and our own internal evaluation, the value obtained by the auction bidding process is the most accurate appraisal that could be obtained. We obtain the best price for each property due to the operation of the auction principle of "urgency." At an auction there exists an urgency to buy that is not available in the conventional market. This urgency is the knowledge that the property is only going to be available this one time (when it is on the auction block) and that if an interested bidder does not try to bid and buy it at that time, the opportunity may never happen again. Also, there are multiple bidders on each property, as many as 7-30 bidders each. There are usually many more bidders than may ever have made an offer on each property in the entire time it has been on the conventional real estate market -- to say nothing of being more than ever were offered in one day! In fact, allegedly, Fannie Mae has made a ruling for its auctions that when three or more bids are received on a property, that is considered the market.

An ancillary, and equally important result of the auction marketing process is the increase in interest in other VA properties generated by the auction sales method. Those people who do not purchase properties at the auction still have earnest money checks in their pockets. They often then use these checks to purchase another VA property through the conventional one-on-one broker method. Rather than inhibiting sales, the auction method is a catalyst to stimulate a failing market. When a new owner of an auction property begins to repair and improve his or her auction purchase, the neighborhood improves. As potential homebuyers view these improvements, they are encouraged to buy in that neighborhood. When neighborhood occupancy increases, vandalism is reduced and the neighborhood becomes more valuable, both in beauty and in safety. This causes home values to increase and re-establishes a conventional sales market in an area formerly without market appeal. In this manner, rather than harming the value of a neighborhood, auction sales greatly accelerate the re-establishment of stable real estate markets.

We have all read numerous articles about the shambles of the housing market in Texas. Home values began declining in the early 80's and reached "free fall" in the mid-80's. There is not one economist who seriously predicts significant improvement in the foreseeable future. If oil prices dramatically increased tomorrow, and the population began growing again, the low end properties being sold at auction would still not recover because they would never improve enough to appeal to homebuyers.

Investors are the logical buyers for less desirable properties. When they pay low prices, it is because the rental market is poor and will not support higher mortgage payments.They have had to resort to speculation. The government cannot afford to be in the business of speculation.

There are thousands of empty apartments, condominiums and houses in most of the troubled economic areas of the country where people have lost their homes through foreclosure or had to go to other places in the country to find work. Many have tried diligently to lease their property and have been unsuccessful and in many such instances this is the reason that the Veterans Administration has had to take these properties back. There were no renters. If the government gets into the renting and leasing business in areas where there are thousands of apartments and empty homes already available, they will not only flood the market with rental properties but create a new even bigger problem by destroying an existing rental system. Thousands of landlords and hundreds of investors now trying to rent property will be unable to compete with the government rental program. These investors in turn would end up giving their properties back to the government entity which financed them. It would be unfair for the taxpayers to have to support this system of rental properties. The sheer size, scope and cost of renting government properties and the ability of the government to be able to collect on these properties or to have tenants evicted would increase the number of jobs in the Veterans Administration and in turn vastly increase the amount of money being spent by the VA.

The discussion draft to amend title 38, United States Code with respect to the loan program also contends that "potential purchasers who have been planning to acquire such properties for use as homes are prevented from purchasing them when the properties are selected for auction with little or no publicity beforehand."

In response to those findings our past experience has shown us that less than 1% of the properties in which the VA pulls for its auctions have or would have had a contract on them prior to the auction. I am personally unfamiliar with this happening more than six or seven times out of the many thousands of properties that we have sold for the Veterans Administration. In many cases, the actual act of pulling the property for auction creates the urgency for a real estate broker to bring a contract to the VA office and plead with them to pull it back out of the auction and sell it conventionally. The potential buyer may still attend the auction and most often pays a higher dollar than his original offer to the VA. It is to the Veterans Administration benefit not to publicly announce that properties are going to be pulled off the market before they are actually put up for the auction.

"As for the publicity that draws thousands of people who come to the VA auction, it is run much like a political campaign with election day being the auction day. Publicity and promotion start three to four weeks prior the auction. The publicity that we are able to generate for the VA is tremendous. In the Illinois auction alone, we provided the VA with more than $112,000.00 worth of free publicity. The public relations campaign told the story of why the Veterans Administration has properties to sell and made thousands of Illinois residents aware that the Veterans Administration had properties besides auction properties to sell to the consumers. The VA should educate the general public continuously regarding the fact that anyone can buy one of their homes.

In conclusion, I am strongly opposed to the legislation before you proposing to do away with one of the oldest most successful sales tools known as "auctions".

The auction method of marketing and sales is just that -- an effective sales tool. Auctions do not cause foreclosures or vandalism or force vacant property into government inventory. Foreclosures and their succeeding results happen because people do not make their mortgage payments on schedule. This is totally unrelated to which type of sales tool proves effective in the later reselling of these same properties.

The auction method has been selected by the VA and other agencies and institutions as the effective and efficient sales tool to remove vacant properties from inventory. To confuse the selection of a sales tool with the earlier events that led to the foreclosure and availability of the properties to be sold is confusing, at best.

I would also like to bring your attention to a Fortune Magazine article last Fall which observed that real estate auctions suddenly have become fashionable and to a Barron's article last year which stated that as much as 20% of our nation's real estate could be sold at auction over the next five to ten years. The auction method has become the fastest growing segment of the real estate and auction industries, says Steven J. Martin, President of the Gwent Group, an Indiana-based auction consulting firm. Last year, more than $25 billion in real estate exchanged hands at auction, according to a study by the non-profit, Certified Auctioneers Institute at Indiana University in Bloomington, Indiana. Dick Dewees who owns Missouri Auction School has also stated that as much as 80% of the people now attending his auction school are real estate brokers determined to get into the real estate auction business. American consumers love to go to auctions for several reasons. The consumer feels like he's getting a very good deal even if he paid more than the list price because he knows that there were other bidders directly below him who bid within a few hundred dollars of what he was willing to pay.

I am asking you to look at the facts and not yield to pressures of special interest groups who are seeing these successful real estate auctions as being in direct competition with their conventional sales methods. They seem determined to use Congress as the vehicle to do away with all other methods of selling real estate and to put down new, exciting, and innovative ways of reducing the current inventories of the Veterans Administration.

The sense of Congress' findings have been based on erroneous facts, misleading information, and in many cases, downright lies from people who do not understand the marketing concept and who will directly benefit by letting the VA inventories increase.

I do not believe that Congress should help these special interest groups limit free enterprise or put the burden of keeping these properties in inventory on the taxpayers. I believe that the Veterans Administration and their regional directors are in day-to-day contact with realtors, buyers, investors and markets and should be able to continue to sell properties using every available means to decrease their inventories.

I hope that I have cleared up many of the erroneous pieces of information presented to you earlier, and I hope that you can feel the frustration of the National Auctioneers Association and myself on the way that auctions have been portrayed by the special interest groups. All methods of sale should be utilized, especially those considered quick and fair. If many of the properties now in government inventories were sold at auction, the on-going burden on the taxpayer could be lifted and the heavy workload on government agencies could be made manageable.

I would like to thank you for allowing me to present my testimony before the Subcommittee on Housing and Memorial Affairs. I will be happy to furnish any additional materials or information at your request.

STATEMENT OF
THE MANUFACTURED HOUSING INSTITUTE
BY
JERRY C. CONNORS
BEFORE
U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON VETERANS' AFFAIRS
SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS
THE HONORABLE MARCY KAPTUR, CHAIRWOMAN

OVERSIGHT AND LEGISLATIVE PROPOSAL HEARING
VETERANS ADMINISTRATION
HOME LOAN GUARANTY PROGRAM

JUNE 16, 1988

MANUFACTURED HOUSING INSTITUTE
JERRY C. CONNORS, PRESIDENT
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The Manufactured Housing Institute

The Manufactured Housing Institute (MHI) is a national trade association representing manufactured home builders and related suppliers of goods and services to the industry and its consumers. Of the top 25 producers of manufactured homes in 1986, 18 were members of MHI. MHI manufacturer members produce over half of the manufactured homes built in the United States.

The Manufactured Housing Insdustry

The advantages of mass production spawned the development of factory-built housing over 50 years ago. Today there are several forms of factory-built homes, including modular, panelized, and manufactured homes. Our remarks concern themselves with the form of factory-built housing known as manufactured homes, formerly known as mobile homes.

Manufactured homes are delivered from the factory in one or more sections. They are completely assembled and require only minimal labor to make them ready for occupancy once delivered to a home site.

Manufactured homes are built to federal standards prescribed by Congress in the National Manufactured Housing Construction and Safety Standards Act of 1974 (P.L. 93-383). These standards were developed and implemented by the Department of Housing and Urban Development (HUD) in June 1976. As a result of HUD's involvement, these homes are commonly referred to as HUD code homes. Since developing the standards, HUD has maintained its surveillance of the manufactured housing industry, primarily through its agent the National Conference of States on Building Codes and Standards.

Innovative technology, improved aesthetics, and a federal construction code that ensures consistent health and safety standards throughout the U.S. have all played a significant role in making manufactured housing an important part of the permanent housing stock in America.

Since the beginning of the decade through the end of the first quarter of 1988, manufactured home builders have produced 2.139 million homes, accounting for 14.8 percent of the 14.497 million privately-owned housing construction started during the decade. The 1983 Annual Housing Survey, the most recent of the annual housing surveys published by the Department of Commerce, indicates that there were 88.6 million full-time occupied housing units at the end of 1983, including manufactured homes. Full-time occupied manufactured homes accounted for 4.7 million, or 5.6 percent of the total occupied housing units in the U.S. at the end of 1983 according to the survey and MHI estimates.

The Veterans Administration Manufactured Home Loan Program

The Veterans Administration (VA) was first authorized to guarantee loans on manufactured homes by the Veterans' Housing Act of 1970 (P.L. 91-506). The 1970 Act provided for termination of the program on July 1, 1975 to give Congress time to evaluate it. The program became permanent with the passage of the Veterans' Housing Act of 1974 (P.L. 93-569), and Congress affirmed its belief that the VA Manufactured Home Loan Guaranty Program was beneficial and provided a good source of housing to veterans.

The program has provided more than 110,000 veterans the opportunity to own their own home since its inception through April 1988. For this reason, we believe that the program is an important and valuable part of the overall benefits provided to veterans through the various activities carried out by the VA.

Manufactured home loans guaranteed by the VA are eligible for pooling into Government National Mortgage Association (GNMA) mortgage-backed securities. So, the VA program also provides an important access to loan funds available through institutional investors and others who buy GNMA securities. Access to investors through secondary markets has become an increasingly important source of funds for housing finance in the 1980's. And, at this time, GNMA is the only organized secondary market source for manufactured home personal property loans.

Mortgage Indemnity Fund

We support the creation of an indemnity fund to protect the Veterans Administration against losses from loan defaults. As drafted, it would appear that the 1 1/4 initial fee is less of a burden to the veteran than the current 1 percent funding fee since the former is allowed to be financed with the loan. Hence, not only has the VA gained some extra protection from loan defaults, the veteran has been aided additionally as well.

We understand the trade-off between the increased fees and releasing the veteran from any liability for defaults on a loan. However, we wonder if such an arrangement might send the wrong message to veteran borrowers. In a sense, they may assume that they have purchased insurance against a default and have every right to use that insurance. We believe that the veteran should continue to be held accountable for loan deficiencies leading to claims paid by the VA. Perhaps some allowance may be made for the indemnity fund fees, but to release the veteran altogether from the obligation on the loan may very well lead to increased defaults.

Shared Equity Program

We would favor a shared equity program to the extent that it would keep the VA program solvent and ensure its continuation over the long term. However, we feel that it may not be well accepted among veterans.

Shared equity programs have been used successfully in some low-income housing programs. The VA program is not necessarily a low-income housing program, although it does provide a much-needed benefit to many low-income veterans and active duty personnel. We feel that a shared equity program would make the VA program unnattractive to veterans with moderate or better incomes who are nevertheless entitled to the program's benefit because of their military service. And, as a practical matter, the problems facing the VA program today are from properties where the veteran had very little, or even negative, equity in the home because of economic conditions in the area.

To charge a moderate fee for the benefit, as has been proposed in the creation of an indemnity fund, seems quite reasonable if the cost is equal to all veterans. However, a shared equity program would create a situation where some veterans are subsidizing others, and we are not sure that a majority of veterans would favor such a program.

The Government National Mortgage Association

We mentioned earlier that the Government National Mortgage Association (GNMA) secondary market program for manufactured home loans is the only organized secondary market for these loans. So, it is important that changes made in the VA home loan program not render manufactured home loans ineligible for pooling under the GNMA guidelines. We would urge the subcommittee to take this into consideration as it deliberates on the various alternatives that may come before it.

Downpayment on Manufactured Home Loans

A veteran who purchases a conventionally built home with a VA-guaranteed loan is not required by the VA to make a downpayment on that loan. A veteran purchasing a manufactured home with a VA-guaranteed loan must make a minimum 5 percent downpayment. We feel that this discriminates against lower-income veterans who purchase manufactured homes. It seems incongruous that veterans purchasing more expensive housing may do so with less cash than veterans purchasing manufactured housing. In light of the mortgage indemnity fund proposal, as well as the stricter underwriting guidelines implemented by the VA over a year ago, we think that the downpayment requirement for manufactured homes should be eliminated and that program put back on a parity basis with site-built housing.

Paperwork Reduction

We recently asked several people in the manufactured housing industry why the VA home loan guaranty program was not used to a greater extent. They felt that one important reason was the paperwork burden of using the program. We would urge the subcommittee to examine ways to reduce and simplify the paperwork required in the program. For example, it may be possible to achieve some consolidation of forms between the FHA's Title I manufactured home loan program and the VA program. Most lenders who make VA guaranteed loans also make FHA Title I loans because of the access these loans provide to the GNMA program. Consolidating some of the paperwork would make these programs more attractive to lenders and increase their availability to home buyers.

Conclusion

We appreciate the opportunity to offer our views before the subcommittee. We feel that the VA program has served veterans well over the years and that veterans deserve to continue to receive its benefits. We support the subcommittee in its search for new and innovative ways to protect the VA program from losses that could threaten its existence.

We support the mortgage indemnity fund proposal, which appears to provide additional protection to the VA and eases the initial cash outlay for the veteran borrower. We feel that while a shared equity program may provide funds for the ongoing operation of the VA program, such a program may not be well received by all veterans and therefore make them less likely to use it. Finally, we feel that the no downpayment provision should be restored to the VA manufactured home loan program to place it closer to a parity basis with the site-built program.

We would be happy to anwer any questions and provide any additional information or assistance that the subcommittee may need.

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Mortgage Insurance Companies of America

Steven P. Doehler
Executive Vice President

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202-785-0767
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June 30, 1988

The Honorable Marcy Kaptur
Chairwomen, Subcommittee on Housing
& Memorial Affairs
United States House of Representatives
1228 Longworth House Office Building
Washington, DC 20515

Dear Chairwomen Kaptur:

The Mortgage Insurance Companies of America (MICA) is pleased to submit the following comments as requested in conjunction with the Subcommittee's hearing June 16, 1988 on the VA Home Loan Program.

This association has said in previous statements to the Subcommittee that we endorse the policy mandated by the Congress to provide a housing benefit to entitled veterans. We believe such a benefit should be delivered as efficiently as possible. At this time the Subcommittee believes that solvency of the VA Home Loan Program continues to be in jeopardy and revenue enhancement initiatives for the program are necessary. The major revenue initiatives under consideration such as to create a veteran funded indemnity program or a "shared equity" program have not universally been seen as feasible by various groups participating at the hearings.

After reviewing the recent hearing it appears that the approach to major reform of the program has not considered going beyond preserving the existing structure of the home loan program. If the Subcommittee's primary goal is the salvation of the housing benefit of the veteran, then any alternative that will minimize the diminution in this benefit and at the same time reduce the governments cost (including the contingent liabilities resulting from the guarantees) should be considered. Would it be advantageous for example, if in lieu of the current program the VA were to make direct cash contributions that could be used by the veteran borrower either toward a downpayment on a FHA or conventionally insured high ratio loan or possibly to finance the premium cost of these insurance programs? This direct funding may prove to be a far more cost effective method of delivering a housing benefit to the vetran.

The Subcommittee obviously recognizes that the basic reason that VA program defaults and operating costs have been high is that many veterans have obtained loans with unreasonable levels of risk. Defaults do not benefit the veteran, the lender or the VA and they may be the result of many factors. For example, the veteran may have attempted to buy more house than he can afford and due to the small downpayment and having little equity in the home the veteran may be less willing to honor his obligation during a period of financial stress. Second, excessive risk in VA loans could result from overlending and poor underwriting performed by some lenders as well as *from poor servicing by lenders. Third, risk may result from the design of the government program itself and the inability of the government to effectively respond to changing market conditions or to enforce market discipline such as in the use of "no bids".*

The problem MICA has in providing further input to the Subcommittee on reform proposals results from the inability to obtain information as to the actual levels of risk that the home loan program assumes. There appears to be little evaluation of program risk available based upon the composition of the individual VA guaranteed loans or according to such factors as lender performance. Today, in the private market, risk is evaluated and priced. Since the cost of the VA program to the government is of such critical importance, it would appear that a more explicit analysis of the VA Home Loan Program risk is needed at this time to make real progress toward reform.

We would urge the Subcommittee to undertake a major review of the program from the perspective of it being operated as a private entity. This may identify current risk levels and more accurately suggest new directions.

Sincerely,

Steve P. Doehler

Steven P. Doehler

SPD/dek

USL
UNITED STATES LEAGUE of SAVINGS INSTITUTIONS WASHINGTON OFFICE
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JIM COUSINS
Senior Vice President for
Legislative Affairs

JUN 22 1988

June 16, 1988

The Honorable Marcy Kaptur
Chairwoman
Subcommittee on Housing and
  Memorial Affairs
Committee on Veterans Affairs
335 CHOB
Washington, D.C. 20515

Dear Chairwoman Kaptur:

The U.S. League of Savings Institutions* is pleased to offer our views on various aspects of the VA home loan program to the Subcommittee on Housing and Memorial Affairs of the Committee on Veteran Affairs of the U.S. House of Representatives in their oversight capacity of this program. We will focus on the legislative and other proposals designed to explore alternative methods of funding the Loan Guarantee Program requested in your letter of May 25, 1988.

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*The U.S. League of Savings Institutions serves the more than 3,100 member-institutions which make up the $1.2 trillion savings association and savings bank businesses. League membership includes all types of institutions -- federal and state-chartered, stock and mutual. The principal officers include: Theo H. Pitt, Rocky Mount, NC, President; B. R. Beeksma, Vice Chairman, Oak Harbor, WA; William B. O'Connell, President, Chicago, Illinois; and Phil Gasteyer, Executive Vice President, Washington, D.C. League headquarters are at 111 East Wacker Drive, Chicago, Illinois 60601. The Washington Office is located at 1709 New York Avenue, N.W., Washington, D.C. 20006. Telephone (202) 637-8900.

THE AMERICAN HOME THE SAFEGUARD OF AMERICAN LIBERTIES

Housing Bill : Discussion Draft

We are pleased to see, as we suggested in our prepared statement of March 16, 1988, that Congress through oversight and legislative proposal hearings, is attempting to address the concept of the program, improvements in the delivery system of it and the costs to continue to fund it today and in the future.

At the time we presented our last statement it was our understanding that some significant in-depth studies were being undertaken on behalf of the Veterans Administration. We suggest that these studies been analyzed to determin whether or not the entitlement feature of the program could be retained while still making the program less costly to finance from the point of view of both the veteran and the federal budget.

We now have a temporary funding fee of 1% that continues until September 30, 1989 (PL 100-198). This would be discontinued if the draft legislation were enacted establishing the collection of the upfront mortgage indemnity fee-of 1.25 percent of the total loan amount. Since this could be financed by the veteran, he or she would not have equity at risk and, because of the mortgage indemnity concept, would have no liability to the administrator with respect to the loan for any loss resulting from his default. We recognize that the investment of the front loading fee will generate income in the early years of the loan and contribute to some extent to the solvency of the program. While the investment feature is a very positive part of the proposal, we question whether an additional 1/4 percent under this approach, supplemented by 1/4 percent premium for three years paid by the government will materially contribute to the solvency of the program.

We are also concerned about the timing and implimentation of any new fee structure. All too often lenders are not given enough advance notice of new requirements or rules to enable the lender to communicate effectively to all concerned parties. This is a particularly important point where applications in progress are concerned. For this reason, we recommend that a much longer lead time be made part of the legislation if any new fee structure is to be enacted.

In addition, we are concerned that, under the definition of mortgage indemnity, a debt would no longer be established against the veteran should there be a default on the loan. We believe that the present slow inflationary environment will continue for the foreseeable future. Since most VA loans are 100% loan-to-value instruments, it will be difficult for the government and the lender to break even, in most markets, when the security must be sold because of defaults that cannot be cured in any other way. If we can keep the veteran in his home it is usually in everyone's best interests. The release of the veteran from liability in the event of default removes one of the very few incentives presently in the program to pay on the loan. Removal of the present deficiency provision will encourage more walkaways and place more burden on the government and the lender.

We are also concerned that the proposal for the government to pay a 1/4 percent premium for the first three years will require appropriations from the Congress and could pace the program periodically subject of funding delays as has been the case with the FHA program.

Housing Bill II Discussion Draft

Section I Sale of Vendee Loans. We will repeat the comment we made in our letter of March 16, 1988. Last year, in our prepared statement, we indicated that the regulation, effective April 3, 1987 to initiate a pilot program to offer vendee loans for sale, without recourse should be utilized. We recognized at the time that loans sold without recourse would have to be sold at a lower price. However, it was our suggestion that accurate cost analysis be prepared under both methods so the most cost efficient method could be determined for sale of these "4600" loans. The experience under the pilot program should be reviewed and evaluated, recognizing that parts of the VA portfolio, because of property location and condition, would have low value relating to original loan amounts under either approach.

Sense of Congress Resolution. The elimination of the auction as a tool for disposal of properties certainly may be appropriate in the most depressed economies of the Southwest and we could support it in these cases. However, there are instances when this approach could be utilized for the benefit of all parties. The resolution should recognize regional differences and even differences within the same region and not attempt to totally eliminate the audition procedures all over the U.S. A blanket exclusion would to be appropriate. The comments we made in our letter of March 16, 1988 should be repeated. The problem of depressed economies, particularly in the Southwest, makes the careful analysis of the VA portfolio and its careful disposition extremely imporant. Because of the poor real estate market and the surplus of properties available from the entire lending community, a fire sale approach could be counterproductive. For example, if the VA sells a property at a price way under the original purchase price in the area and provides a vendee loan to the purchaser, what does that do to the other VA borrowers in the immediate area who are making payments on a house now worth, according to the above subject comparable, much less than the mortgage they owe. Would not they be inclined to walk, too?

We recognize the VA is carefully tracking in each market the status of its inventory and the various options for disposition of each property. We would suggest that each loan be carefully examined so that each loan is carried per the most professional estimate of the best time to sell it considering the potential rental income and the costs to carry it. As part of the REO workout, each problem asset must be analyzed to determine what caused the problem and how the problem can be solved. The risks and rewards of various strategies and tactics can be evaluated based on the options for structuring the workout with the objective to sell at market value after an objective appraisal of each approach has been built into a financial model of the various solutions. A marketing plan will need to be developed that will result in maximum investment recovery. Professional property management needs to be utilized either internally or through outside professionals while the property is held in inventory.

We believe consideration should be given to alternative lease/purchase programs to recover the VA's investment.

Proposal of Professor Robert Edelstein

Professor Edelstein's proposal has merit from a theoretical standpoint; however, the administrative cost of the program may consume much of the potential benefits to the VA. The Committee should consider, however, whether this plan is consistent with the traditional treatment of the VA loan program as an entitlement. In addition, where there was minimum equity buildup the costs of sale could encourage some veterans to walk rather than worry abut very minimum recovery. The shared equity programs in the private sector have met thus far with only limited success. Any possible tax consequences to the veteran would have to be explored and analyzed prior to implementation.

Improving the VA Home Loan Program

We suggest review of our entire comment letter of March 16, 1988 to improve the program.

As we mentioned before, everything within reason should be done to keep the deserving veteran in his house. One of our members, Lincoln Service Corporation of Owensboro, Kentucky, has proposed a plan and submitted it to the VA Claims Chief in Denver. It is an idea to defer and possibly reduce losses to both VA and lenders in certain distressed markets. It is worthy of further examination. Here is a summary of that program:

Lincoln Service Corporation
VA Foreclosure Avoidance Plan

Criteria

1. Veteran occupies property and has desire to maintain ownership even though account is in default and foreclosure sale is eminent.

2. Veteran is gainfully employed, but presently experiences curtailed income compared to income at time of origination of account. While resources are not available to pay all delinquent payments, charges and fees, present income will meet amortization requirements of new loan at original CRV at currently prevailing rate of interest.

3. Foreclosure sale will result in "no-bid election" by the Veterans Administration.

Program

1. Lincoln Service obtains minimum documentation from veteran as determined by Veterans Administration.

2. Payoff balance is computed and original CRV is deducted to determine outstanding Guaranty payment required. Statement presented to Veterans Administration whereupon expedited payment of Guaranty amount is returned to Lincoln Service with approval for roll-over refi of account at original CRV and at prevailing interest rate. (Discount points and prevailing fees and cost of new loan origination must be included due to veteran's inability to pay closing costs.)

3. Veterans Administration and Lincoln Service executive agreement stating that Loan Guaranty on the new loan is an amount equal to the original Loan Guaranty on the original loan less the amount paid by Veterans Administration to facilitate the roll-over refi hereinabove stated, or $17,500, whichever is greater.

4. Ultimately, in the event the account again proceeds to foreclosure, Veterans Administration reanalyzes the account for consideration of the no-bid election and makes such determination in considering the new curtailed Loan Guaranty amount.

CONCLUSION

The U.S. League appreciates the opportunity to present this prepared testimony for inclusion in the hearing record. It is our desire to see the various trade-offs carefully considered so the VA program can be tightened and made more effective in light of today's conditions. As and entitlement program the VA loan program should serve the needs of deserving veterans in the most cost effective way for the government and lenders who will only continue to make these loans if they are economically viable.

Sincerely,

Jim Cousins

Jim Cousins

STATEMENT OF

VIETNAM VETERANS OF AMERICA, INC.

submitted by

PAUL S. EGAN
LEGISLATIVE DIRECTOR

to the

HOUSE VETERANS AFFAIRS
SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS

on

HOME LOAN PROGRAM REFORM PROPOSALS

JUNE 16, 1988

Madam Chairwoman and members of the subcommittee, the Vietnam Veterans of America, Inc. (VVA) appreciates this opportunity to present its views on various proposed initiatives to improve the VA's home loan guaranty program. As we are all painfully aware, this program has been costing increasing amounts of scarce tax-payer resources. In spite of the wisdom of maintaining this program as an avenue for the purchase of property by veterans, often the only such avenue available to many first time home buying veterans, it seems likely that the congressional will to continue supporting this program will diminish unless something is done to stop the hemorrhage of red ink.

Last year this subcommittee undertook bold legislative steps to reform this program and many of those steps were ultimately enacted thanks to the leadership of the distinguished subcommittee Chair and in spite of strong opposition to some legislative provisions by entrenched parties with clear financial interests in the program. This year, as last, this program must again be revisited with reform in mind and this year, as last, reform must be fashioned with the understanding that this is a veterans' benefit program rather than a banker's, builder's, real estate broker's or appraiser's program.

As the VVA has stated repeatedly, most recently at this subcommittee's March 17, 1988 hearing, the problems facing this program are serious. They are problems of fiscal stability, marketing and management. Each is urgent, yet in the last several years that each of these problems has emerged and persisted the VA has failed to properly adjust.

The program has and continues to face problems with extraordinary rates of foreclosure. Yet, the VA has failed continuously to properly market its bloated inventory of foreclosed property. Added to this is the over-arching problem the program has faced in losses of revenue that would otherwise have been available but for the ill advised policy initiated in 1981 to sell off the program's income generating home loan portfolio. Each of these problems is serious and each is in need of correction.

While it is unclear why high foreclosure rates have remained at high levels for an extended period of time, it would be an error to conclude that the fault lies with "dead beat" veterans ignoring their financial obligations. Instead there are more likely explanations to be found in current and developmental national economic trends. We have seen plant closings and widespread layoffs as the heavy industrial base of the nation's economy has transformed itself into a service economy. International events and conditions have created devastating circumstances in areas of the country dependent on oil and oil related industries. Until the economy levels out as a service economy and as long as prosperity in some parts of the country depends on international events beyond our control, we probably can expect foreclosure rates to continue at high levels.

Notwithstanding the tragedy befalling those veterans experiencing the loss of their homes through foreclosure, there do appear to be some things that the VA could do, and should have been doing, to avert the fiscal crisis that currently threatens the overall program.

The VA must find a way to unshackle itself from the bureaucratic inertia that has prevented it from aggressively marketing its foreclosed properties at other than "fire sale" prices. For policy makers in and out of Congress with direct concern for the program, it will be critically important to identify the obstacles to aggressive marketing and address them directly.

As with the marketing of property, the VA must be required to aggressively rebuild its income generating home loan portfolio. The VVA made its suggestion, in this connection, at this subcommittee's March 17 hearing. That proposal would authorize the VA to borrow funds from the Federal Reserve at the discount rate and make direct home loans to veterans at the significantly higher maximum VA-established interest rate. However unlikely it might be for Congress to approve this proposal for whatever political climatic reasons, it is this kind of proposal to which the subcommittee could most constructively direct its attention.

Importantly, it seems clear that if we rely upon the VA alone for proposals, few necessary or constructive corrections can be expected to be made. Already this year, in the Administration's proposed budget for the next fiscal year, proposals were made to increase user fees and restrict guaranties by reforming federal credit policy.

On balance, just as this is a veterans' benefit program rather than a financial fiefdom for those who stand to profit from it, the solutions must proceed from a basic acknowledgement that the veteran users of the program are exonerated from responsibility for its fiscal problems. Moreover, the most appropriate policy choices to be decided upon must shelter the user while facilitating a departure from the VA's business-as-usual response to the program's problems. This departure from bureaucratic paralysis cannot be reasonably expected if the only program changes made are limited to and aimed at short term fiscal deficiencies by restricting user access.

On balance, then, there are two principles that should serve as a prism through which home loan program reforms should be seen; the program is a benefit program and real program improvement requires adjustments aimed at correcting underlying systemic rather than short term problems; and those proposals that would restrict user access ignore the program as a benefit. Similarly, those proposals that would simply generate short term infusions of capital into the Loan Guaranty Revolving Fund (LGRF) would ignore the long term stability of the program. With these principles in mind, we shall present the VVA's views on each of the proposals under current consideration.

The first proposal would establish a program providing mortgage indemnity for veterans who default on their mortgage loans. This would be funded by requiring a 1 1/4 percent fee to be paid by the veteran. The fee could be incorporated into the total mortgage amount so as to prevent added up-front expenses. This fee would be complemented by a 1/4 percent premium paid for by the federal government over the course of each of three years. The concept of providing indemnification for veterans is a sound one and it is generally supported by the VVA.

However, we would recommend that the premium be reduced and held at one percent, the same as the currently imposed user fee. To make up the difference, we suggest giving serious attention to the imposition of a 1/4 percent contribution by the financial institutions using the program. In order to prevent the banker's added cost from being passed on to the veteran, however, a further statutory bar to this effect should be adopted. In our view it seems reasonable to expect bank contributions as a way of fortifying their own indemnification against losses incurred when a veteran defaults.

Our support for this particular proposal is predicated on acceptance of an additional proposal to terminate the current one percent user fee upon enactment. The fee has constituted a regression tax on veteran users of the program in that the veteran has received nothing in exchange for paying the fee. It will be recalled that part of the original rationale used to justify imposing the fee held that since FHA buyers pay a fee, so too should veterans. Apparently missed in the debate at that time, however, was the fact that FHA buyers were actually paying a fee for the purchase of mortgage insurance. For veterans the fee has been paid with no similar added benefit.

Another proposal would authorize the continued sale of the program's home loan portfolio assets but only if sold at 90 percent or more of asset value. It is difficult to imagine why this proposal is being entertained. Sales may provide short term assistance for the faltering Loan Guaranty Revolving Fund, but by selling these assets the long term benefit of asset income will be lost.

It may be that these sales are required by budget reconciliation. Even still, this is the wrong target for budgetary savings. Were it otherwise, it may not have been necessary for large new appropriations to have been added to maintain LGRF solvency over the last few years. Moreover, it might also be worth noting that this subcommittee bore the brunt of nearly all Veterans Affairs Committee budget reconciliation savings last year. Can this really mean that there are virtually no other VA accounts that can be trimmed?

An unrelated but significant proposal would preclude the VA from disallowing claims for waiver of overpayment in cases involving sales of home loan assumptions by deciding the question of "equity and good conscience" on the basis of whether the veteran can afford to pay the indebtedness even though there was no material fault on the part of the veteran. Assuming that we are reading this proposal's intent correctly, this particular proposal is long overdue.

Currently in these cases the claim for waiver of indebtedness makes its way up through the VA adjudicative apparatus where it finally reaches the Board of Veterans Appeals (BVA). The BVA must determine whether the veteran is "materially at fault" for the indebtedness created by the default of a subsequent buyer of a loan assumption. Often the BVA decides that no material fault on the part of the veteran exists and remands the case to the originating Regional Office where a determination is made on a second question of whether equity and good conscience should compel a decision to allow the waiver.

In determining the judgment on this second question, consideration is given to the veteran's financial condition and whether his or her future earning capacity would be sufficient to repay the indebtedness. If the veteran can afford to pay the debt or can be expected to be able to repay the debt in the future, the Regional Office ordinarily finds against the veteran.

In our view, if the BVA finds no material fault on the part of the veteran, the veteran's financial condition or future earning capacity should be irrelevant and the claim should be allowed at the BVA rather than being remanded to the originating Regional Office. In cases where the BVA finds the veteran to be at material fault, the case should be remanded for a determination of whether equity and good conscience requires the waiver.

Moreover, when the BVA finds no material fault on the part of the veteran, the debt should not simply be waived. Instead it should be proclaimed never to have existed. In this way, the veteran is protected from being taxed by the Internal Revenue Service (IRS). Currently the IRS regards a waiver of indebtedness as income.

This added proposal concerning the declaration by the BVA in these cases that no indebtedness has existed is not without precedent. Educational benefit overpayments are treated similarly when waived due to personal hardship, death in the family or economic distress as reasons for dropping out of school prior to the end of a term, semester or school year.

A related proposal should also be considered with regard to home loan indebtedness as a way of preventing these problems. When the VA attempts to notify the veteran of an impending indebtedness in these claims, it should be required to do so by using certified mail with return receipt requested. Unless the VA can produce the receipt proving that the veteran has been alerted to the sheriff's sale or foreclosure sale of the property involved, the veteran should never be charged with the indebtedness. Sadly, the veteran is charged in the absence of proof all too frequently.

Often in these cases the only defense available to the veteran is to show, according to the laws of the state where the property is at issue, that the VA has failed to take reasonable steps to notify the veteran of the impending foreclosure sale and possible indebtedness if the sale yields too little. With potentially 50 different state laws on this subject, it is difficult for the veteran to defend himself or herself with the use of veterans' service organization claims representatives alone. This is not only because of different state laws, but also because the real estate laws of most states are arcane and extremely complicated. Since the veteran is barred from spending more than $10 on a real estate attorney for purposes of mounting a defense at the administrative level prior to being taken to court by the VA, it makes good sense to at least require the VA to produce a receipt showing the veteran to have been notified.

Finally on this subject, the proposal, if adopted as modified by the VVA's suggestion, should apply not only to all such claims subsequent to enactment, but also to all such pending claims.

Before addressing the equity sharing suggestion posed by Professor Edelstein at the March 17 hearing, there is one final legislative proposal to express the sense of Congress that the VA refrain from disposing of property through auctions and encourage the VA to lease inventoried property with incentives such as an option to buy. It is clear enough to us that the VA's practice of auctioning property at "fire sale" prices is disapproved in most quarters of Congress. If recent history is any guide, it seems unlikely that expressing a non-legally binding sense of Congress will deter the VA from its current practice. Instead, perhaps a legally binding legislative provision should be incorporated to require a halt in this particular practice until such time — perhaps within 90 days of enactment — as the VA produces a report detailing its plans for marketing its foreclosed property inventory. The feasibility of leasing VA properties with options to purchase is a question requiring some degree of study. For example, we have concerns that the cost to VA of maintaining these properties might be increased if too many purchase options go unexcercised and the property is poorly maintained by the tenants.

Professor Edelstein's equity sharing proposal is obviously a thoughtful one which holds out the possibility of generating significant income for the VA's LGRF. While the VVA is inclined to disapprove of this proposal for a variety of reasons we shall describe, if it is approved by the subcommittee, first time home buying veterans should be exempted. First time home buyers can ill afford to lose any portion of net equity earned as a result of increasing property values. As is widely understood in today's housing market, first time home buyers often settle for less in their first homes because of the high cost of housing. Most such home owners fully expect to sell these first homes a few years after purchase so as to take advantage of earned equity in purchasing another more suitable home. To deny these first time home buying veterans any portion of the earned net equity accumulated over the course of the period the initial properties are occupied could seriously diminish these first time home buyers' chances of purchasing a better home later. The first time home buyer is already sacrificing enough in his or her willingness to settle for less in the short run without also asking him or her to risk losing the opportunity to advance to more appropriate housing later.

For the subsequent user of the VA's home loan program the burden may not be as onerous. Even for these program users, however, when moves are required from one region of the country to another, because of employment transfer for example, many program users will need all of the equity earned in order to purchase comparable property.

With further regard to equity earned on the holding of a property, there is an almost intangible kind of equity for which no one but the property holder should benefit. This kind of equity is the "sweat" equity some property holders earn as a result of the time, effort and expense devoted to improvements.

There is also the problem of how the equity might be taxed by the Internal Revenue Service. If a veteran were to deposit in the VA some 10 percent of the equity earned on a property at the time of sale, the veteran would most certainly be taxed unless some specific provision of the proposal barred such taxation.

In conclusion, this particular proposal recognizes the principle that the home loan program is a benefit program. However, it fails to meet the requirement of the second principle holding that the veteran user not be penalized for problems stemming from VA mismanagement.

Madam Chairwoman, that concludes our statement.

Office of the
Administrator
of Veterans Affairs

Washington DC 20420

AUG 4 1988

Veterans
Administration

AUG 3 1988

Honorable G. V. (Sonny) Montgomery
Chairman, Committee on Veterans'
Affairs
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Enclosed please find the Agency's responses to questions which you forwarded on behalf of Congressman Dan Burton for the June 16, 1988, hearing on VA's Loan Guaranty Program. Thank you for the opportunity to provide this additional information for the record.

Sincerely,

THOMAS K. TURNAGE
Administrator

Enclosures

cc: Honorable Dan Burton

"America is #1—Thanks to our Veterans"

QUESTIONS OF THE HONORABLE DAN BURTON
SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS
JUNE 16, 1988

1. CAN VA SUGGEST A WAY TO MODIFY THE VA FUTURE LIABILITY DRAFT PROVISION TO PREVENT OR DISCOURAGE POSSIBLE ABUSE WHICH COULD RESULT IN INCREASED FORECLOSURE RATES?

It is VA's position that borrower liability to reimburse the Government for losses suffered as a result of loan defaults should be maintained.

2. WHEN CAN VA RESPOND TO THE ISSUES IDENTIFIED IN ITS STATEMENT AT P. 3?

We do not expect to be able to respond to these issues until Peat, Marwick, Main & Co. has completed its feasibility study of mortgage insurance options and we have had an opportunity to analyze the results.

3. IF YOU CAN PREDICT IT OR OTHERWISE DETERMINE IT, WHAT DO YOU EXPECT THE AMOUNT OF THE DISCOUNT TO BE ON THE NO-RECOURSE LOAN SALES NOW PLANNED?

Our first non-recourse loan sale of 1988 closed on June 29 with the following results:

Number of Loans Sold	8,903
Principal Balance of Loans Sold	$ 308,937,863
Principal Balance of Senior Certificates	$ 203,821,000
Principal Balance of Subordinate Certificates	$ 105,059,272
Proceeds to VA from Sale of Senior Certificates	$ 178,884,248

The total discount on the sale of the senior certificates, taking into account all costs of the sale, amounted to $24,936,752. This equates to a discount of 12% on the balance of the senior certificates. The subordinate certificates were not sold.

There is not sufficient data available to predict the results of future non-recourse sales.

4. VA EXPRESSES A CONCERN THAT A LOSS OF INCENTIVE TO REPAY LOANS WILL OCCUR AMONG VETERANS, IF THE DRAFT BILL'S NO FUTURE LIABILITY WERE ENACTED.

IN SITUATIONS WHERE THERE IS NOW MORTGAGE INSURANCE, IN FHA MORTGAGES, FOR EXAMPLE IF FORECLOSURE OCCURS, IS THE MORTGAGOR STILL LIABLE FOR ANY DEBT RESULTING FROM FORECLOSURE?

It is our understanding that FHA may request a loan holder to seek a deficiency judgment against liable obligors if such a judgment is obtainable under state law and it appears likely that a debt would be collectible after foreclosure. We have no information on the extent to which this procedure is used by FHA or on the actions taken by private mortgage insurors in this regard.

5. WHAT WOULD THE VA'S REACTION TO A MORATORIUM ON FORECLOSURE AUCTIONS IN A PARTICULAR AREA BE, IF IT COULD INCLUDE ALL OR NEARLY ALL OF THOSE AUCTIONS IN THE AREA, AND NOT JUST THE VA's?

VA would not object to a moratorium on foreclosure auctions in a particular area if all holders of foreclosed properties would agree. Unless there is unanimity, VA and the others who agreed to the moratorium would be at a disadvantage in the marketplace.

6. WITH RESPECT TO RENTING OR LEASING OF FORECLOSED PROPERTIES, HAS THE VA EXAMINED FHA PRACTICES, AND DOES THE VA BELIEVE SUCH A RENTING OR LEASING COULD BE USEFUL FOR ITS PROPERTY MANAGEMENT?

We understand that the policy of the Department of Housing and Urban Development with respect to the rental of its residential acquired property inventory is not substantially different from VA's. Both VA and HUD policy provide that rental may be warranted if properties which are left vacant are subject to excessive risk of damage by vandals or other hazards. Additionally, for VA purposes, a property may be rented, for a limited time, to its former owner with an option to purchase as a means of determining his or her willingness and ability to make the projected monthly payments in a timely manner. VA will also consider renting a property if there is little likelihood of an early sale of the property. In this regard, VA's policy is somewhat more expanded than HUD's.

Financial considerations regarding the Loan Guaranty Revolving Fund have necessarily influenced our decisions with respect to offering properties for rent. The Fund is replenished principally through sales of acquired properties, including income derived from loans which VA made incident to such sales and including proceeds from the sale of such loans themselves to investors. A rental/lease program would hinder VA's near-term ability to replenish the Fund, since rentals and leases do not provide the same lump-sum infusion of cash that is obtainable from property sales and loan sales. Substantial cash infusions into the Fund are necessary in order to limit the need for Congressional appropriations.

7. IS VA NOW USING MULTIPLE LISTING SERVICES FOR SALE OF FORECLOSED PROPERTIES?

Multiple Listing Service (MLS) is a registered trade mark which is owned by the National Association of Realtors (NAR). The use of MLS is restricted to members of NAR who must pay additional fees to join and list their properties in the local MLS. For a property to be eligible for listing in MLS, the member-broker must have a written listing executed by the legal owner granting an "exclusive right" to sell the property, i.e., the seller guarantees that if the property is sold, regardless who sells it, during the period of the listing that the member-broker will receive the sales commission stated in the listing. Therefore, the listing broker can then create a sub-agency with all the members of that MLS guaranteeing that the member who sells the property will receive a prearranged portion of the commission which is stated in the published listing. For many years, the governing board of MLS has refused to waive this requirement. However, they have recently agreed to allow local Boards of Realtors the option to list Government owned properties in a listing section similar to, but completely segregated from, MLS. At present, we are awaiting a final interpretation from NAR whether this separate listing section can be maintained in computerized MLS or solely in MLS published in a paper format.

We are testing the use of exclusive listing agreements with competitively awarded management brokers' contracts in Texas and California. One provision of these contracts requires that the property listings assigned to the management broker be placed in a multiple listing system such as MLS. If these tests result in reduced holding costs and quicker sales, we plan to make the management broker contract available to all regional offices.

8. IN RECENT LOAN SALES, WHAT HAVE BEEN THE DISCOUNTS ON NON-RECOURSE LOANS?

VA has held only one non-recourse loan sale. In that sale, which took place on June 29, 1988, senior certificates were sold at a discount of 12%.

9. IS THE VA RENTING OR LEASING ANY OF THE PROPERTIES IN ITS CURRENT INVENTORY?

Yes. VA currently has less than one percent of its property inventory rented.

10. CAN THE VA PROVIDE AN ACTUAL ESTIMATE ON HOW MUCH THE NO FUTURE LIABILITY DRAFT/PROVISION FOR VETERANS WOULD INCREASE FORECLOSURES IN THE LOAN GUARANTEE PROGRAM?

No. We do not believe there is any way to accurately project the amount of the increase.

SENT BY:Xerox Telecopier 7020 ; 9- 8-88 ; 3:35PM ; 3→ 2255488:# 2

Kidder, Peabody & Co.
Incorporated
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10 Hanover Square
New York, N. Y. 10005

Marvin Markus
MANAGING DIRECTOR

July 13, 1988

Honorable Marcy Kaptur, Chairwoman
Subcommittee on Housing & Memorial Affairs
U.S. House of Representatives
Committee on Veterans' Affairs
335 Cannon House Office Building
Washington, D.C. 20515

Dear Ms. Kaptur:

Attached are responses to the five follow-up questions you requested that Kidder, Peabody answer with regard to the Veterans Administration's home loan guaranty program sale.

Please let me know if I can be of any additional assistance.

Sincerely,

Marvin Markus

Marvin Markus

/ml

Attachment

QUESTIONS OF THE HONORABLE MARCY KAPTUR
TO KIDDER, PEABODY, AND COMPANY, INC.
BEFORE THE SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS
JUNE 16, 1988

1. ARE YOU PERFORMING THE MATHEMATICAL RECOURSE - NON-RECOURSE COMPUTATION FOR THE JUNE LOAN SALE? ARE YOU BEING PAID ADDITIONALLY FOR THIS RESPONSIBILITY?

Kidder, Peabody is currently performing the recourse/non-recourse computation for VA's June loan sale. We are not being paid additionally for this responsibility.

2. COULD YOU PLEASE EXPLAIN HOW THE SUBORDINATE POOL OF LOANS OPERATES.

Subordinalton is a form of "internal" credit enhancement. When a senior/subordinated lien structure is used, as with the American Housing Trust, the owners of the senior securities have first call on the cash flow from all of the loans owned by the Trust. Only after they have received the payments due them are the owners of the subordinate or junior securities entitled to receive payments. In essence, one could say that the Trust has two pools of loans -- one senior and one subordinate. The subordinate pool of loans is used to make up cash flow shortfalls for loans in the senior pool that experience losses. If no such shorfall exists, the cash flow from these loans goes to the owner of the subordinate securities.

3. WERE THERE ANY LOANS INCLUDED IN THE JUNE LOAN SALE WHICH VA WOULD NOT USUALLY INCLUDE IN THE PACKAGE?

VA's June loan sale included loans with a wider variety of coupons than would likely be found in subsequent loan sales. This is due to the fact that in June, VA's portfolio encompassed a wide range of loans which had not been sold in previous recourse sales. (In such transactions, an effort was made to sell loans with a narrower range of coupons in order to simplify the bidding process.) Other than this "backlog" of loans, the portfolio sold in June should be substantially similar to those sold in the future.

4. WERE THE LOANS GIVEN A TRIPLE A RATING? IF SO, DOESN'T THIS SERVE TO ENHANCE THEIR VALUE? WOULD INVESTORS BE PROMPTED TO DEMAND SIGNIFICANT DISCOUNTS?

The senior securities sold by the American Housing Trust were rated triple-A on the basis of 1) the 34% overcollateralization level of the loans; and 2) the guarantee provided by the American Loan Guarantee Association (ALGA). This rating was a key determinant of the price paid by investors for the Trust's senior securities. The subordinate securities would not be covered either by the same overcollateralization level or by ALGA's guarantee. As a result, they would not receive the same high rating and would be sold at a commensurately lower price. Purchasers of VA's loans would demand significant discounts if these two types of protection were not provided.

5. WHAT IS THE DIFFERENCE BETWEEN SELLING LOANS WITH RECOURSE AND OVER-COLLATERALIZATION?

Prior to the June 1988 transaction, VA's Vendee Loans were sold with recourse. That is, the Federal Government was fully liable for all loans which experienced delinquencies and went into default. Such loans were repurchased by VA and were ultimately cured or foreclosed. When subordination or overcollateralization is used, a "worst case" scenario is developed by the rating agencies and assumed by the investing public. If the portfolio performs better than that worst case, then that better performance accrues to the benefit of VA or any subsequent purchaser of the subordinated securities. If it performs worse, the investor (or the bond insurer, depending on how the transaction is structured) takes the loss.

1125 Fifteenth Street, N.W.
Washington, D.C. 20005

Mortgage Bankers Association of America

Robert M. O'Toole
Staff Vice President
Residential Finance/
Government Agency Relations
(202) 861-6334

August 4, 1988

Ms. Marcy Kaptur
Chairwoman
Subcommittee on Housing
and Memorial Affairs
U. S. House of Representatives
335 Cannon House Office Building
Washington, D.C. 20515

Dear Madam Chairwoman:

MBA is pleased to respond to follow-up questions from the June 16, 1988 hearing on the VA home loan program. Our responses are attached.

If you or other members of the subcommittee wish additional information, please do not hesitate to call upon us.

Sincerely,

Robert M. O'Toole

mls

Question: A staff member recently conducted a random survey of lenders in the Washington metropolitan area. The results indicated that most lenders are willing to lock in interest rates for VA loans. Is this true around the country? If not, why not?

Answer: Based on a survey of several of our major members around the country, it appears most lenders currently issue firm commitments on VA loans which lock in the interest rate and points irrespective of any VA rate change that may occur prior to the commitments expiration. Each lender we spoke to cited competitive pressure as the primary reason for allowing VA lock-ins. Otherwise, they said, the marketing risk is too great. Some smaller lenders in markets where VA lock-ins are not as critical to the lender-selection process indicate a continued unwillingness to issue firm commitments because of the risk.

Question: Do you perceive any difference between FHA and VA loans in this regard?

Answer: For major lenders allowing lock-ins there is no difference between their treatment of FHA and VA commitments other than disclosing the fact that a VA rate change has no effect on a VA lock. For those few who do not allow them, the only difference we perceive would be the pricing treatment of the VA's prevailing rate versus FHA's free rate at the time of loan closing. Depending on what discount points are prevailing at the time of closing, the veteran could find him or herself at a disadvantage, if, for example, he is forced to pay five points for a ten percent loan rather than three for a ten and a half percent, and the seller is unwilling to pay the extra points. An FHA borrower, on the other hand, would be able to choose the latter pricing. Individual lender policies under such circumstances, of course, vary widely.

Question: How much should the funding fee be for no down payment loans, if there is a sliding scale for fees, depending on the amount of the down payment?

Answer: We have not done an in depth analysis of the proper fee levels for the sliding scale proposal. MBA would be pleased to conduct such an analysis if the committee feels the proposal has merit. In doing such a study a thorough review of the claim experience by down payment would of course be necessary.

Question: Can MBA estimate the number of additional full time equivalent employees (FTEE's) needed for adequate staffing of the home loan guaranty program?

Answer: VA's Loan Guaranty field staffing levels are grossly inadequate. Throughout most of the 1980s, staffing levels have remained stable during a time when workloads have increased substantially. For example, in Fiscal Year (FY) 1987 there were three more staff positions assigned to the Loan Guaranty Divisions than in FY 1981. However, during the same period of time, loan applications increased 166 percent; foreclosures processed increased 181 percent; and property inventory increased 97 percent.

It may be helpful to look at a couple of specific regional offices to explain the seriousness of this situation. At the Houston Regional Office in FY 1981, 118 full-time personnel were assigned to the

Loan Guaranty Divisions. At the end of the FY 1987, the same 118 positions were assigned. However, the property inventory increased from 392 to 5,449, a 1,400 percent increase. Also, loan volume increased from 14,209 to 18,657 and foreclosures processed from 473 to 6,518.

The St. Petersburg Regional Office is another case in point. In 1981, the employment number was 145; in FY 1987 it was 107. However, property inventory increased in the same time period from 273 to 515; loan volume increased from 12,300 to 33,418; and foreclosures processed increased from 347 to 1,250.

The VA can provide information which shows that similar situations exist in many regional offices. Unless the staffing deficiencies are addressed soon, the system will shut down. Serious morale problems will develop if employees are unable to see an end to the overloaded conditions. The use of overtime becomes counterproductive in the long run, as employees end up doing the same amount of work but put in longer hours. Further, serious doubts exist about the quality of the work being performed when such a serious understaffing situation exists.

In addition to a minimum allocation of 300 - 400 additional employees for the loan program, the VA must look very closely at its resource allocation system which allows regional office directors to assign employees to Divisions within the regional offices, often contrary to the wishes of the Congress. My view is that Central Office officials must direct the assignment of resources to the loan divisions. This is the only way there can be assurance that staff assignments are made as intended.

Question: Why is the home loan guarantee program experiencing financial problems now, after it for many years operated solvently?

Answer: The budgetary mechanism for the loan guaranty program is the Loan Guaranty Revolving Fund, which was established to balance the income and expenses associated with operating the program. Income for the Revolving Fund is derived primarily through the sale of "vendee" loans, which are direct loans made by the VA to finance the sale of VA-acquired properties. Other sources of income are the 1 percent funding fee, income from the loan portfolio, and appropriations. Expenses incurred by the Revolving Fund are predominantly for the acquisition of foreclosed properties securing guaranteed loans. Because of severe economic and market conditions in some parts of the country, there has been a significant increase in the number of foreclosures of VA loans.

In the past, when the Revolving Fund was in a deficit position, the VA transferred earnings from its Direct Loan Revolving Fund (DLRF). The DLRF was created in 1950 to make direct loans to veterans who lived in areas with housing credit shortages and could find no private lender to make VA-guaranteed loans. In these cases, the VA acted as lender, and the interest on the direct loans provided the VA with net earnings in the DLRF.

However, in the early 1980s a number of changes were made. In 1981, the VA was instructed by the Administration to make no more direct loans except to severely disabled veterans for specially adapted housing. In 1982, the Administration began a policy of selling Federal assets, which has resulted in the sale of most of the portfolio of direct loans held by the DLRF. Therefore, the role of the DLRF as a source of income for the Revolving Fund has been greatly diminished.

Throughout the 1980s, the Administration has continued to push the sale of Federal assets and has proposed to sell all vendee loans without recourse. The sale of vendee loans without recourse shifts the credit risk to the private purchasers, who necessarily adjust their purchase prices accordingly. It can be expected that the reduction in the sale price paid to the government will be greater than any savings it might realize by transferring the risk of default.

The First Boston Corporation
Tower Forty Nine
12 East 49th Street
New York, New York 10017
Telephone: 212/909-2823

First Boston

Jonathan Plutzik
Managing Director

July 14, 1988

The Honorable Marcy Kaptur
Chairwoman
Subcommittee on Housing
and Memorial Affairs
U.S. House of Representatives
Committee on Veterans' Affairs
335 Cannon House Office Bldg.
Washington, DC 20515

Dear Ms. Kaptur:

Thank you for the opportunity to testify before the Subcommittee. Enclosed are our responses to your follow-up questions on the June loan sale by the Veterans Administration.

If we can provide any additional information, please let me know.

Very truly yours,

Enclosure

/jr

0261D

QUESTIONS OF THE HONORABLE MARCY KAPTUR TO THE FIRST BOSTON CORPORATION BEFORE THE SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS
JUNE 16, 1988

1. ARE YOU PERFORMING THE MATHEMATICAL RECOURSE - NON RECOURSE COMPUTATION FOR THE JUNE LOAN SALE?

   No. First Boston is not performing this analysis. We understand that VA's Financial Advisor, Kidder, Peabody and Co., is preparing these calculations.

   ARE YOU BEING PAID ADDITIONALLY FOR THIS RESPONSIBILITY?

   No, First Boston is not being paid to perform this analysis.

2. COULD YOU PLEASE EXPLAIN HOW THE SUBORDINATE POOL OF LOANS OPERATES?

   In the Veterans Administration's June loan asset sale, the "senior/subordinated" method of credit enhancement was used in combination with bond insurance. VA sold Vendee loans to the Trust which issued two types of ownership interests in the loans: Senior Certificates and Subordinate Certificates. The Senior Certificates which were sold to investors received a triple A credit rating because of the 34% subordination level and the insurance policy provided by the American Loan Guarantee Association (ALGA).

   The Senior Certificates have the first lien or claim on the cash flows from the underlying mortgage loans. The Subordinate Certificates which initially have been retained by VA have a right to receive cash flows only after payments are made on the Senior Certificates. Thus the Subordinate Certificates bear the risk of any shortfalls in cash flow due to delinquencies and defaults on the underlying mortgage collateral.

3. WERE THERE ANY LOANS INCLUDED IN THE JUNE LOAN SALE WHICH VA WOULD NOT USUALLY INCLUDE IN THE PACKAGE?

   In addition to loans that would normally be sold in a recourse sale, loans that were not sold in previous recourse sales were included in the June loan sale. As a result, the range of coupons was greater in the June sale than in past recourse sales.

4. WERE THE LOANS GIVEN A TRIPLE A RATING? IF SO, DOESN'T THIS SERVE TO ENHANCE THEIR VALUE? WOULD INVESTORS BE PROMPTED TO DEMAND SIGNIFICANT DISCOUNTS?

   The Senior Certificates issued by the Trust and securitized by the Vendee loans were given a triple A rating, not the Vendee loans themselves. In order for the Senior Certificates to achieve a triple A rating, credit enhancement of 34% subordination and bond insurance was necessary. With the triple A rating, the Senior Certificates were sold to investors at rates comparable to those for similar triple A rated securities.

   The Subordinate Certificates currently being retained by VA bear the risk of any losses on the mortgages. However, losses on the mortgages are limited to the subordinate amount of 34% of the collateral. If the Subordinate Certificates were sold to investors, investors would demand a discount which would represent the yield investors would require for assuming the credit risk of losses on the mortgages. If the loans were sold without any form of credit enhancement, investors would demand greater discounts.

5. WHAT IS THE DIFFERENCE BETWEEN SELLING LOANS WITH RECOURSE AND OVER-COLLATERALIZATION?

   In a recourse sale, VA sells Vendee loans to investors with a repurchase agreement in which VA guarantees that if a loan becomes delinquent and defaults, it will repurchase the loan at the original purchase price. Thus, in a recourse sale, through the repurchase agreement, VA remains fully liable for losses on each loan sold for the entire life of the loan. Since VA bears the credit risk on the mortgages, investors are willing to pay a higher price for the loans than if the investors were asked to assume that credit risk.

   In the non-recourse sale just completed in June, the Vendee loans were sold using the senior/subordinated method of over-collateralization to credit enhance the senior securities purchased by investors. With the over-collateralization method, the risk of losses on the mortgages is borne by the Subordinate Certificates. However, unlike the recourse method, in the overcollateralization method the liability for those losses is limited to the subordination level, 34% subordination in the recent sale.

National Association of Home Builders

15th and M Streets, N.W., Washington, D.C. 20005
Telex 89-2600 (202) 822-0500 (800) 368-5242

Martin Perlman
Vice President/Treasurer

Reply to:
Perl Homes, Inc.
10555 NW Freeway, Suite 131
Houston, TX 77092

July 18, 1988

The Honorable G.V. Montgomery, Chairman
House Veterans' Affairs Committee
United States House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Per your request, I have attached my response to the question submitted by Representative Dan Burton on the mortgage indemnification program. This is in follow up to the hearing held by the Subcommittee on Housing and Memorial Affairs on June 16, 1988 on solvency in the VA Home Loan Guaranty Program.

Thank you for allowing us to present our views.

Sincerely,

Martin Perlman

Martin Perlman
Vice President/Treasurer

Response by Martin Perlman, V.P. and Treasurer, of the National Association of Home Builders, to the question submitted by the Honorable Dan Burton. This question was in follow up to the hearing held on June 16, 1988 on solvency in the VA Home Loan Guaranty Program.

HOW MUCH WOULD THE INDEMNIFICATION PREMIUM NEED TO BE, IN YOUR VIEW, TO MAKE THE INDEMNIFICATION PROGRAM ACTUARIALLY SOUND?

As we testified before the VA Subcommittee on Housing and Memorial Affairs last month, we questioned whether the two percent mortgage indemnification fee envisioned by the Subcommittee was enough to make the program self-sustaining. We felt that an additional appropriation or capital infusion would be necessary. For the single family program under the Department of Housing and Urban Development (HUD) to be actuarially sound a 3.8 percent premium is collected and that program requires a downpayment. It has also accumulated reserves over the years to protect the program. The mortgage indemnification program would not have the benefit of established reserves.

The Congressional Budget Office (CBO), however, has estimated that a two percent loan indemnification fee is adequate and that not only would the program be actuarially sound from the beginning, there would be a $1 billion surplus at the end of ten years. The CBO also stated that the existing program under the Loan Guaranty Revolving Fund (LGRF), which currently requires appropriations by Congress, would no longer need these appropriations after three years. We have concerns with the CBO analysis for the following reasons.

First, if the current LGRF program would be self-sufficient in three years, there would be no need to make a complete overhaul. The current Home Loan Guaranty Program has been in existence since 1944 and changes to the entitlement program must be carefully weighed by Congress.

Second, some of the assumptions made by CBO in their forecasts appear overly optimistic. For example, CBO estimates that default rates under the MIF will be more favorable than recent experience requiring fewer outlays. Yet, under the indemnification program the veteran is released from liability if the loan goes into foreclosure, which could cause much higher default rates.

Additionally, there is a study which the VA has contracted with Peat, Marwick, Main and Company to explore the design of a viable insurance program which would maintain its status as a veteran's benefit. The study is to address the premiums which would have to be charged, who would pay them and the size of the reserve necessary to run the program. This analysis should be completed soon and the Subcommittee may want to consider these results before moving forward with legislation.

Finally, the Senate has passed legislation creating an Independent Commission on the VA Home Loan Guaranty Program. The commission's charge is to look into ways of improving solvency in the LGRF, reducing defaults and foreclosures and disposing of VA properties. This would be an excellent opportunity to further study the impact and costs of the Subcommittee's loan indemnification plan.

LARRY LATHAM
AUCTIONEERS

10304 N. Hayden Road, Suite 6
Scottsdale Arizona 85258
(602) 998-1168

July 12, 1988

The Honorable Marcy Kaptur
U.S. House of Representatives
Committee on Veterans Affairs
335 Cannon House Office Bldg.
Washington, D.C. 20515

Re: Questions of the Honorable Marcy Kaptur to Mr. Larry Latham
Before the Subcommittee on Housing and Memorial Affairs
June 16, 1988

Dear Representative Kaptur:

Again, thank you for allowing me to testify before the Congressional Subcommittee on Housing and Memorial Affairs.

I have tried to answer the four questions proposed to me in your letter of June 29, 1988, concerning the auctioning of Veterans Administration homes. I will be happy to be of any further assistance to the subcommittee upon your request.

Respectfully,

LARRY LATHAM AUCTIONEERS

Larry W. Latham, CAI
CEO/President

/jgp

1. Do auctions differ from government agency to government agency?

Yes, there are many differences in the way government agencies market their properties. Many government agencies and quasi-government agencies use the auction method. I have sold properties for Farmers Home Administration, the Department of Housing and Urban Development, Small Business Administration, the Veterans Administration, FDIC, FSLIC, and the Federal National Mortgage Association. Most of these agencies are using the auction method of marketing to a much greater extent than the Veterans Administration. Several government agencies have been using the auction method for many years and have had great success in marketing their properties.

Certain government agencies, such as the IRS and the GSA, use their own in-house auctioneers. Most other government agencies contract with a full-service auction company. These full-service auction companies are responsible for advertising, promoting, and implementing the auctions.

My opinion is that the private sector auctioneers, which are contracted by the government, do a much better job at promoting and conducting these auctions, than do the government in-house auctioneers. I believe that the Veterans Administration has done an excellent job in creating their auction program. Over the past four years, the Veterans Administration has studied and implemented many of the finest auction procedures that are being used in the industry today. They have developed and initiated more guidelines than any other government agency. The Veterans Administration constantly monitors the promotion and progress of each VA auction by using a sophisticated computer program which was developed for the tracking of auction properties. While I believe no other government agency is doing such a thorough job on the auctioning of their properties as the VA, they do differ in the following ways from other government agencies:

A. Most of the other government agencies, such as HUD, FANNIE MAE, SBA, FDIC and the FSLIC, sell many of their properties at absolute auction. In fact, absolute means there is no minimum bid. These absolute auctions usually bring higher sales prices for the properties than do reserve auctions. HUD and the SBA sell 10-30% of their selected auction properties at absolute auction. The Veterans Administration currently sells no properties at absolute auction. Absolute auctions usually bring much higher prices and larger crowds. Many auction buyers prefer absolute auctions over reserve auctions and, therefore, only attend and buy at absolute auctions.

B. While most government agencies and quasi-government agencies agree to finance their properties, The Veterans Administration sells all of their properties at auction for cash, with no vendee financing. The Veterans Administration's policy of selling auction properties for cash creates a source of money to replenish their revolving fund.

C. Many agencies such as Farmers Home Administration, SBA, and FANNIE MAE auction their prime properties. The Veterans Administration is selling properties at auction which have been in inventory for over six months and are the very properties that are usually in the worst section of town, vandalized and almost indisposable by any other means. This gives the false impression that auctions bring lower prices. When auctioning top quality property, the opposite appears to be true, because top quality properties bring top dollar prices.

D. The Veterans Administration auctions are directed on a national basis out of Washington, D.C. Fannie Mae, Freddie Mac, and FLSIC direct auctions at a Regional level. HUD contracts for auctioneers on both a regional level and a local level. HUD and the VA use the negotiated RFP process to select their auction contractors which identifies qualified contractors prior to looking at just the lowest price.

These are a few of the major differences between the Veterans Administration auctions and other government agency auctions. There are many minute details which differ from government agency to government agency in the way they dispose of properties at auction. However, I think you will find that most government agencies have found the auction method of marketing to be a fair and expedient way to recoup dollars from their REO inventories.

2. Do you auction government properties differently than those held by the private sector?

The auctioning of private sector properties does differ from government properties in a few ways. While both government and private properties are advertised and promoted in much the same manner, the sellers of private properties usually spend much more money in the fix-up and maintenance of their properties before going to auction. The private sector also spends a larger amount for advertising and promoting the auction. Government auctions are much more detailed than private sector auctions, due to the paperwork and follow-up required by the contractor. Many auction companies refuse to do government work because of the number of restrictions imposed upon them by the agency. The following are a few more differences between private sector auctions and government auctions:

A. Private sector properties are taken off of the market as long as 12 weeks prior to the auction, compared to 4-6 weeks for a government auction.

B. Private sector advertising and promotions usually run twice the amount paid for government auctions. The government auctions do receive more free publicity which offsets the amount paid by the private sector.

C. Most of the private sector auctions include some or all absolute properties, whereas the government auctions include a few absolute or all reserve properties.

D. Outside real estate brokers become more involved in co-broking with the auctioneer in government auctions than in private sector auctions. Real estate brokers only co-broke on about 2 to 10% of the properties sold by the private sector. The amount of co-brokerage which occurs on government auctions can reach above 70%.

E. The type and condition of properties which are sold by the private sector are usually in much better condition and in much nicer locations than the properties which are currently sold by the government at auction.

F. Government auctions draw larger crowds and more bidders than do private sector auctions because of the credibility given to the properties by the government's ownership.

3. You stated in your testimony that appraisals quickly become outdated in relation to sales prices. Is there a remedy for this?

I believe there is no "quick fix" for the problem of appraisals becoming outdated in relation to sales prices. But first, please understand how these appraisals are determined, especially by the Veterans Administration. An appraisal is done on a property that has a VA loan guaranty prior to the lender beginning foreclosure proceedings on that property. This appraisal forms the basis of the VA's bidding instructions to that lender. The appraisal is often 6-9 months old by the time the VA takes the foreclosed vacant property into its inventory.

At the time the property enters the VA inventory, a management broker is assigned to the property. This management broker does an initial inspection of the property for VA files and then is contracted to complete a monthly inspection of the property for the period that it remains in the VA inventory.

The original foreclosure appraisal is generally not updated prior to sale of the property from inventory, nor is the condition of the property evaluated. In many cases, vandalism is a regular occurrence that is undermining the value of the property. In an area in which economic downturn drastically affects the housing market, as has been the case in the Houston region for the past five years, appraisals would need to be done almost on a monthly basis to keep pace with the falling home prices and the escalating failure of the market. The VA does not have the staffing to implement updating procedures on its inventoried properties, even though the agency recognizes the unreliable nature of many of the older appraisals.

Traditionally, in the real estate industry, appraisals are used as the major criteria to determine the value of a property, both for pricing purposes and for obtaining of financing. There is an underlying assumption that the appraisal accurately reflects the market in which that property is located and the condition of the property. However, this basic and critical assumption breaks down when an appraisal becomes quickly antiquated by both the fluctuations of the economy and the vandalism prevalent for empty homes as has happened in many areas of the country in recent years. Not only does an out-dated appraisal not reflect the true market value of a property -- it also can cause the making of unsound business decisions regarding the disposal of a piece of real estate. When the listing price is set based on such an appraisal, the seller is deceiving itself and probably discouraging its market from ever purchasing that property.

In the case of the VA properties, the listing price is set based upon a combination of factors, including the lender's original liquidation appraisal (often 6-9 months old), the current price opinion from the management broker, and from comparison to sales of other VA homes in the neighborhood. When a property does not sell, the listing price is reduced repeatedly in hopes of interesting the marketplace. As the months go by, the price reduction lags behind the market's deflation, and the VA may never be able to represent a true market -- regardless of the appraisals in the VA files. I suggest that the best appraisals are set by multiple buyers as in an auction situation.

When multiple buyers are bidding on a property at auction, the price is greatly increased because of the competition.

Significantly, the VA auction bidders are cash buyers. There is a critical distinction between the cash value and the financed value *of a property*. Our experience has proven repeatedly that when a property is offered for cash only, whether in one-on-one sales or by auction, the true market value of that property will be lower than that of a property offered with financing. We bring cash buyers to the VA auctions. The VA does not want to re-guarantee the auction properties or make direct loans on them. The agency does not ever want these properties back in inventory. The only way that these properties can be marketed is for cash sale. And, the VA needs these cash dollars to put back into the revolving fund to provide more loan guarantees for veterans. The auction method of real estate sales allows the VA to accomplish this goal quickly and economically.

Between the people attending the auction who are offering cash for the properties and our own internal evaluation, the value obtained by the auction bidding process is the most accurate appraisal that could be obtained in the real estate market. We obtain the best price for each property due to the operation of the auction principle of "urgency." At an auction there exists an urgency to buy that is not available in the conventional market. This urgency is the knowledge that the property is only going to be available this one time (when it is on the auction block) and that if an interested bidder does not try to bid and buy it at that time, the opportunity may never happen again.

The combination of auction buying urgency with the multiple bidder effect is a strong factor in stimulating the bidders to offer the highest and true market price for each property. In this manner, the auction brings the market for each VA property offered. Therefore, the only remedy that I could advise would be to dispose of the properties much sooner than is now being done and to use the auction method where appropriate.

Page Seven
Questions of the Honorable Marcy Kaptur to Mr. Larry Latham
Before the Subcommittee on Housing and Memorial Affairs
June 16, 1988

4. Since you are familiar with the Houston market, don't you think it advisable to keep some of these properties occupied to avoid vandalism? Wouldn't this ultimately net a better return for the Federal Government irregardless of disposal method?

Yes. I am familiar with the Houston market and am quite aware of the number of empty apartment complexes in that area--some of which have sold for as low as $2,000.00 per unit. It would be advisable to keep all the abandoned properties occupied in order to avoid vandalism, but it is not realistic. I believe this is a negative solution and will increase the government's problem of owning homes. I agree that in markets such as Houston the holding down of vandalism will definitely save the government some money in the immediate future; however, the cost of repairing the unit after it has been leased will probably cost the government more money in the long haul. I would be against any rental program for the following reasons:

A. The Veterans Administration was not set up as a landlord or collection agency.

(1) The collection of rents would become very costly and in many cases almost impossible to collect.

(2) The VA would have to expand its personnel; and, therefore, increase its workload and budget.

B. Many lessees would leave the home in a much worse condition than when they moved in.

C. Many neighborhoods could face radical changes because of a government rental program being conducted in their location.

D. The Veterans Administration will be in direct competition with private sector rental programs and current government housing programs.

I suggest that we not get the government involved in any type of a rental program that may directly increase the operating cost and budget of that agency, and that we work toward the cutting of the carrying cost and the possibility of vandalism by disposing of the REO headaches in a timely and reasonable manner. The government should consider whatever means constitutes the fairest and quickest return to the agency.

Office of the
Administrator
of Veterans Affairs

Washington DC 20420

Veterans
Administration

JUL 27 1988

Honorable G. V. (Sonny) Montgomery
Chairman, Committee on Veterans'
Affairs
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Enclosed please find responses to questions raised by Chairwoman Marcy Kaptur following the June 16, 1988, hearing regarding VA's loan guaranty program. A copy of these responses has been provided to Chairwoman Marcy Kaptur.

Sincerely,

THOMAS K. TURNAGE
Administrator

Enclosure

QUESTIONS OF THE HONORABLE MARCY KAPTUR
TO THE VETERANS ADMINISTRATION
BEFORE THE SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS
JUNE 16, 1988

LOAN ASSET SALES

1. ISN'T IT TRUE THAT THE LOAN GUARANTY REVOLVING FUND NEEDS AN INFUSION OF CASH IN THE SHORT-TERM IN ORDER TO AVOID REQUESTING LARGE APPROPRIATIONS?

The Loan Guaranty Revolving Fund has required a substantial amount of appropriations in FY 1988. The initial appropriation of $389.8 million has been supplemented by a $200 million transfer from the Readjustment Benefits Account followed by a $526.6 supplemental appropriation. At this time we believe the fund will not need further appropriations this fiscal year.

2. IF THIS IS TRUE, WOULDN'T THE POOL POLICY METHOD OF ENHANCING THE CREDIT ASPECTS OF THE LOAN ASSET SALES BE MORE LIKELY TO GENERATE CASH UPFRONT THAN BOND INSURANCE?

Yes. Under a "pool policy" VA would agree to reimburse the Trust up to a fixed dollar amount for cash flow shortages and losses due to delinquencies and foreclosures. This would generate more cash proceeds upfront than use of bond insurance for credit enhancement.

3. PLEASE PROVIDE AN ESTIMATE OF THE NET PROCEEDS ON THE DATE OF SALE WHICH WOULD HAVE BEEN REALIZED USING THE POOL POLICY METHOD VERSUS THE NET PROCEEDS ACTUALLY RECEIVED AT THE RECENT LOAN SALE.

Application of a 100% pool policy to the sale held June 29 would give the following results:

Structure	Senior/Subordinate	Pool Policy
Sale Amount	$308,937,863	$308,937,863
Certificates sold (at 10.43% average yield to investors)		
(face value)	$203,821,000	$308,823,500
(cash proceeds)	$186,830,420	$279,857,542
Rating	AAA	AA
Costs of sale		
(issuance)	$ 2,303,000	$ 2,303,000
(insurance)	$ 5,643,172	None
Net proceeds	$178,842,248	$277,554,542
Certificates retained by VA (face value)	$105,059.272	None
VA contingent liability	Minimal	$139,472,031 (45% of sale)
Anticipated VA costs under contingent liability	Minimal	$ 13,069,410

(Assuming 10% foreclosure rate and 60% recovery on property resale)

LOAN PRODUCTION SYSTEM (LPS)

4. WILL THERE BE SUFFICIENT FUNDS AVAILABLE FOR THE NEXT THREE FISCAL YEARS TO IMPLEMENT LPS?

There are no funds in the FY 1989 budget for the LPS project. We are currently reviewing our funding needs for a number of ADP projects in conjunction with the FY 1990 Agency budget process. We expect to go forward with a budget request that provides adequate funding for LPS.

5. IF NOT, WHAT IS YOUR OPINION OF LEGISLATION WHICH WOULD PERMIT FUNDING FOR THE PROJECT TO BE PAID OUT OF THE LOAN GUARANTY REVOLVING FUND?

We are very interested in completing LPS because it will provide more efficient timely service to veterans in a cost effective manner. The source of funding for LPS is secondary from our perspective.

DEBT COLLECTION

6. HOW DOES VA ESTABLISH HOME LOAN DEBTS?

Veteran-borrowers who purchase homes with VA-guaranteed loan financing agree to indemnify the Government for the amount of any claim VA may have to pay the loan holder as a result of a default on the loan. When a default occurs, the amount of claim payable is calculated using the procedure set up by 38 USC 1832. Unless the veteran has been released from liability on the loan, a liability account for this amount is established in VA's records and collection action is initiated. In jurisdictions where a legal deficiency can be obtained against other obligors in addition to the veteran, liability accounts are established against each liable obligor for the full amount of the claim paid.

7. ARE THERE DIFFERENT CRITERIA FOR ESTABLISHING VENDEE LOAN DEBTS?

Vendee loan borrowers do not agree to indemnify the Government against loss in the event of a loan default. As a result, vendee loan debts are only established where applicable state law gives VA the right to enforce collection of a deficiency after foreclosure. Where VA does have the right to establish and collect on a debt, the amount of debt is calculated using the same procedures set forth for veteran-borrowers under 38 USC 1832 with the exception that, since no guaranty is involved, the amount of the debt can exceed the dollar limit which would apply in the case of a guaranteed loan.

8. WHAT PROCEDURES ARE USED TO COLLECT DEBTS?

Debt collection procedures are the same for Loan Guaranty debts as for any other delinquent debt due the Veterans Administration. When the debt is first established, a check is made to determine if the debtor is drawing any other benefit from the VA that can be offset to liquidate the indebtedness. If so, the debtor is notified and offset action is initiated. If not, the account is established in the Agency's Centralized Accounts Receivable Section (CARS) and a series of collection actions begins. The VA first tries to contact the debtor through a series of collection letters and obtain payment in full or an acceptable repayment plan. If this fails, the debtor is reported to a credit reporting agency. Once a year, the VA refers all eligible delinquent debts to IRS for offset of any income tax refund to which the debtor might be entitled. The VA also performs periodic matches with other Federal Agencies to determine if the debtor is employed by the Federal Government. If so, action is initiated to begin salary offset proceedings to liquidate the debt. Any debt over 1 year old is considered seriously delinquent and is subject to referral to a private collection agency for further collection action. If information is obtained during the collection process that indicates collectibility, the debt will be referred to a VA District Counsel or the Department of Justice for litigation.

9. WHY IS NET VALUE USED INSTEAD OF FAIR MARKET VALUE IN ESTABLISHING INDEBTEDNESS?

The estimated net value of the property to the Government is the amount which is normally credited to the loan indebtedness under the provisions of 38 USC 1832. The same law sets the amount of claim payable by VA as the difference between the total loan indebtedness and the net value (so long as this amount does not exceed VA's maximum guaranty liability). Under the provisions of 38 CFR 36.4323(e), the borrower's liability to the Government is for the amount of the claim paid by VA.

10. WHAT PERCENTAGE OF OUTSTANDING DEBTS ARE COLLECTED? IS THERE A DIFFERENCE BETWEEN GI HOME AND VENDEE LOANS? WHAT IS THE AVERAGE AMOUNT OF A HOME LOAN DEBT?

In FY 1987, 5.2 percent of outstanding debts were collected (this is the ratio of debt collections to debt establishments). While we do not have separate statistics on these debts it is likely that a greater percentage of GI loan debts are collected. The average amount of a home loan debt established in FY 1988 is $14,869.

11. PLEASE EXPLAIN THE WAIVER PROCESS.

When furnishing notice of a home loan debt, VA advises veteran-obligors that a waiver or compromise of the debt amount may be requested through administrative procedures established pursuant to 38 USC 3102. If the veteran subsequently submits a request for such relief, the matter is referred to a Committee on Waivers and Compromises at the VA Regional Office which has jurisdiction over the case. The Committee will then consider the veteran's circumstances and may waive recovery of the debt if it is determined that collection would be against equity and good conscience and the veteran is found to not have been at material fault in the creation of the debt.

If it is determined that the debt should not be waived, the veteran is provided with a written notice explaining the basis for the Committee's finding and procedures for submitting a "Notice of Disagreement" with the decision in the event the veteran wishes to file an appeal. When a "Notice of Disagreement" is received, the case is returned to the Regional Office Committee for reconsideration. After considering any new evidence furnished by the veteran, the Committee may then affirm, modify or reverse the initial decision regarding the debt.

If the decision is affirmed, the veteran is provided with a "Statement of the Case" and advised of procedures for requesting a substantive appeal for review by the Board of Veterans Appeals. The Board will consider any appeals which are requested and will issue final decisions of the Agency based on its findings and conclusions with respect to the evidence presented.

12. HOW MANY WAIVERS WERE GRANTED LAST YEAR?

The VA received 10,278 waiver requests on Loan Guaranty debts last year. Of this total, 973 waivers were granted.

13. IN HOW MANY INSTANCES IS A COMPROMISE OFFER ACCEPTED? DO YOU FIND THIS TO BE AN EFFECTIVE MEANS OF AVOIDING THE DEBT ESTABLISHMENT/COLLECTION PROCESS?

In FY 1987, the VA received 578 compromise offers, of which 163 were accepted. In the collection process, VA does not consider a compromise offer until after a debt is established. Therefore, a compromise offer in no way affects the establishment of a debt. If a debtor took advantage of the compromise process, it could be an effective means of avoiding the debt collection process. However, based on the number of compromise offers received, few debtors choose this option to avoid paying the debt.

GENERAL

14. THE MANUFACTURED HOUSING INSTITUTE URGES CONSOLIDATION OF FORMS BETWEEN FHA'S TITLE I MANUFACTURED HOME LOAN PROGRAM AND THE VA PROGRAM IN AN EFFORT TO MAKE THESE PROGRAMS MORE ATTRACTIVE TO LENDERS THROUGH PAPERWORK. (sic) WOULD YOU PLEASE COMMENT ON THIS PROPOSAL.

Currently there are joint FHA/VA forms for loans for site-built homes. In order to promote further standardization for lender processing we would be more than willing to consider similar joint forms for the manufactured home loan program.

15. COULD YOU PLEASE PROVIDE A COPY OF THE RECENT RELEASE ON SUPPLEMENTAL LOAN SERVICING WHICH IS BEING DISTRIBUTED TO HOLDERS AND SERVICERS OF GI LOANS?

A copy of DVB Circular 26-88-25, dated May 10, 1988, on supplemental servicing is attached.

16. COULD YOU PROVIDE A COPY OF THE CONTRACT WITH PEAT, MARWICK, MAIN & CO. WHICH REQUESTS THE FIRM TO CONDUCT A FEASIBILITY STUDY OF VARIOUS MORTGAGE INSURANCE OPTIONS. WHAT IS THE PRICE OF THE CONTRACT?

A copy of contract number V101(93)P-1096, task order 8, with Advance Technology (Peat, Marwick, Main & Co. are subcontractors) is attached. Price for tasks 1 and 2 is $55,645. Price for task 3 is to be negotiated upon completion of task 2.

17. PLEASE PROVIDE A COPY OF THE CONSULTING CONTRACT WITH BOOZ, ALLEN, HAMILTON, INC. WHICH INITIATES AN ANALYTICAL AND STATISTICAL VALIDATION OF THE LOAN GUARANTY BUDGET PREPARATION PROCESS. WHAT IS THE COST OF THIS CONTRACT?

A copy of contract number V101(93)P-1097, task order 7 with Booz, Allen & Hamilton Inc. is attached. Price is $74,055.

Department of Veterans Benefits
Veterans Administration
Washington, D.C. 20420

DV Circular 26-88-25

May 10, 1988

SUPPLEMENTAL LOAN SERVICING

1. Despite the relative stability of the unemployment rate nationwide, and the moderate interest rates prevailing, the present and immediate future outlook for delinquent GI loan borrowers is not promising. The number of defaults, foreclosures, claims and property acquisitions associated with VA-guaranteed loans continues to rise. At the same time, the number of VA personal servicing contacts is declining. Reduced personal servicing will inevitably lead to unnecessary foreclosures in cases when communication and/or cooperation between the veteran and the loan holder has broken down. Increased emphasis on personal supplemental servicing is essential to fulfilling VA's goal of assisting veterans to avoid foreclosure and retain their homes. Eliminating avoidable foreclosures will result in a corresponding reduction in claim and acquisition payments, costs which VA can ill-afford.

2. As always, the primary responsibility for servicing delinquent GI loans rests with the loan holder. VA expects holders to service these loans in accordance with generally accepted industry standards. Holders should be aware of VA policies and regulations through review of VA regulations, station releases and VA publications such as the Lender's Handbook.

3. Monitoring of the Holder's Servicing

a. In order to properly assess the quality of the holder's servicing efforts, the notice of default must be reviewed with a critical eye. Guidelines for this review are contained in M26-3, paragraph 3.11. Our examination of quality ratings for large volume GI loan holders indicates that holders are usually assigned a rating of "2," which signifies average or acceptable servicing. This rating is not always justified according to review of cases submitted to Central Office for various reasons. In many such cases, it is noted that holders' failed to perform adequate servicing, yet the station assigned acceptable, or even excellent, ratings. Holders that are not performing up to industry standards may be causing some foreclosures that could otherwise be avoided through appropriate contacts with delinquent borrowers. If we do not properly identify these holders, we cannot counsel them or make a determination on possible suspension action.

b. When a notice of default contains servicing information which is clearly inadequate, the holder should be requested to submit a supplemental report (M26-4, par. 2.16e). We believe that consistently requesting such additional reports is an effective way of getting a holder to upgrade its servicing procedures.

c. Early reporting of defaults was addressed in DVB Circular 26-88-14, and includes cases when the property is abandoned, the obligor advises no further payments will be made and any other cases when there is a possibility that a delay in termination may expose the security to waste or other hazard. Also, defaults by transferees on loans closed prior to March 1, 1988, should be reported to VA within 15 days after the loan becomes 2 months delinquent. In such cases, field stations should authorize prompt termination action unless servicing by the holder and/or VA develops a reason for forbearance.

d. Any instance in which it appears that a holder is not complying with a VA policy or regulation should be documented and brought to the attention of the holder's management. Such instances include failure to comply with partial payment regulations (38 CFR 36.4275(f), 36.4315(b) and 36.4600(c)(15)) or to accept full arrears (38 CFR 36.4275(e) and 36.4308(g)). Adherence to these regulations is essential as failure to do so could result in a foreclosure that would otherwise be avoidable.

4. VA Supplemental Servicing. When a notice of default is coded into LCS (Liquidation and Claims System), a servicing letter is computer-generated and forwarded to the borrower. These letters, VA Forms 26-8761, Notification to Borrower of Default; and 26-8762, Notice to Borrower Regarding Foreclosure of Mortgage, are being amended in order to provide a description of the various options for reinstating the loan or otherwise avoiding foreclosure. While such letters are a useful servicing tool, at times they are ignored by borrowers who are several months delinquent and may be somewhat discouraged about their chances for reinstatement. When a review of the notice of default does not indicate that the default is insoluble, a prompt and thorough effort must be made to contact the borrower and perform personal supplemental servicing. This can be done by telephone, office or field visit (most contacts will necessarily be made by telephone). Telephone contacts are often more successful during evenings and weekends. Stations should seriously consider the use of irregular tours and weekend office hours for this purpose. In those cases when a personal contact is not feasible, a personally worded letter may be effective.

a. Notice to Original Veteran. It is extremely important that FL 26-251 be sent to the original veteran if a transferee now owns the property. Failure to do so may present legal problems concerning due process, and may preclude VA from seeking collection of any loss from the veteran. Stations should review their procedures in this regard (M26-3, par. 2.24, as well as DVB Circulars 20-86-14 and 26-87-46).

b. Attitude Toward Borrower. When interviewing the delinquent obligor, the loan service representative should be firmly in control, while letting the borrower know that VA is sincerely trying to help him or her to reinstate the loan.

c. Information Requested. Sufficient information should be developed to make a determination concerning whether the borrower can afford to repay the loan at the present time or in the near future. VA Form 26-6808, Loan Service Report, was revised for this purpose.

d. Pay Plan Appears Feasible. If the information developed during the interview with the borrower indicates that there is sufficient income to maintain a reasonable repayment plan, the borrower should be advised of VA's recommendations and told to contact the holder with the terms of the proposal. The borrower should also be aware that he or she should call VA if the holder does not agree to the plan. When the borrower does call VA in such circumstances, VA will contact the holder and intercede on the borrower's behalf. When discussing the matter with the holder, it is important to have the borrower's financial information at hand in order to present a strong, well-documented case for acceptance of the proposed plan. Such instances are prime examples of cases in which VA servicing can make a clear difference in assisting borrowers to reinstate their loans.

e. Financial Counseling. If the borrower's difficulty in making mortgage payments appears to be of a temporary nature, or otherwise results from poor management of income, he or she should be advised and encouraged to take advantage of VA financial counseling.

f. Non-VA Assistance. Stations should be aware of benefits and services offered by State and local agencies to delinquent/unemployed/low income borrowers, and should refer such borrowers to these agencies whenever appropriate (see DVB Circular 26-87-17).

g. Refinancing Loans. If it appears that reducing the interest rate on the loan would enable a veteran to afford payments on the loan, the veteran should be advised to apply to his lender or another local lender for an Interest Rate Reduction Refinancing Loan. If the veteran provides VA with evidence of such an application, VA may request forbearance from the loan holder to allow sufficient time for processing of the application prior to foreclosure.

h. Refunding. When a holder declines to grant further forbearance but the veteran has the ability to resume payments immediately (or in the near future), consideration should be given to refunding the loan. When determining the size of the monthly payments the veteran would have to make to VA, stations may allow for a reduction in the interest rate on the loan to as low as 3 percent below the current maximum GI rate (see M26-3, par. 2.39).

i. Liquidation Likely. When the default is clearly insoluble, there are still possibilities for avoiding foreclosure and/or limiting VA's potential losses, including the following:

(1) Private Sale of Property. When reinstatement is unlikely, the borrower should be advised to put the home up for sale immediately. If there is little or no equity, the borrower should be made aware of the possibility of a compromise agreement and advised to keep VA informed as to any offers received for the property (see M26-4, pars. 2.10 and 3.07 and M26-3, par. 3.11k(4) for guidelines and coding instructions concerning compromise agreements). In any instance when the borrower is attempting to sell the property and submits a copy of a valid purchase offer (with a firm closing date), VA may contact the holder and request a postponement of the foreclosure sale if necessary to permit the private sale to close.

(2) Deed in Lieu of Foreclosure. Concurrent with advice concerning private sale of the property, it will normally be appropriate to suggest that the borrower offer a deed in lieu of foreclosure if this will substantially reduce VA's loss. Traditionally, approval results in a complete release of liability of all obligors on the loan, and will only be granted when the likelihood of collection is remote. However, stations may now consider the acceptance of funds from the obligor in partial payment of VA's estimated loss. For example, if there is slight potential for collection of the full loss, but the obligor offers to pay half of the estimated loss in exchange for a full release, it may be better to accept the offer than attempt to collect the full loss after foreclosure (see M26-4, par. 2.18).

5. Successful Intervention by VA. In many cases VA may intervene with the holder on the veteran's behalf to arrange repayment agreements, periods of forbearance to allow for a private sale of the property, etc. It is essential that VA maintain an accurate record of such successful interventions, since this shows that VA supplemental servicing has a positive effect on foreclosure avoidance. Instructions for intervention coding are contained in M26-3, pars. 2.35e and 3.11e.1.

6. Stations will reproduce exhibit A of this circular for distribution to all lenders, holders and servicers. Copies of these releases need not be submitted to Central Office.

7. RESCISSIONS

a. DVB Circular 26-80-3 and changes 1, 2, and 3.

b. DVB Circulars 20-75-58 and 26-86-5 (unrelated rescissions).

R. J. VOGEL
Chief Benefits Director

Distribution: CO: RPC 2023
SS(26A1) FLD: DVBFS, 1 each (Reproduce and distribute based on RPC 2023)

DVB Circular 26-88- 25 May , 1988
Exhibit A

TO: All Lenders, Holders, and Servicers

The Veterans Administration requests your continued cooperation in extending appropriate forbearance to delinquent borrowers who are experiencing temporary financial difficulties.

When a default is reported to VA, the report should show in detail what actions you have taken to contact the obligor and assist him or her to reinstate the loan. It is important to include current information on the obligor, such as work and home telephone numbers, so that VA may contact the obligor and perform supplemental servicing if you have not been able to make arrangements with the obligor for reinstatement of the loan.

Generally, VA expects holders to provide delinquent obligors with any reasonable opportunity for reinstatement of their loans, and to do so in accordance with the standards of the mortgage servicing industry. We strongly object to certain holders' policies of taking "hard-line" approaches to establishing repayment agreements. This results in many instances when the obligor can afford a reasonable repayment plan but needs VA assistance in order to convince the holder of the merits of agreeing to such a plan. While holders are required by regulation to accept full or partial payments under certain circumstances, this does not mean that forbearance should be declined if these regulations are not applicable in any particular instance.

Our records indicate that a substantial number of defaults cure even after foreclosure has begun. Obligors should be afforded every reasonable opportunity to reinstate their loans regardless of the duration of the default or whether foreclosure action has been initiated. We note that provisions of Public Law 100-198 are being implemented which protect holders against cases becoming "no-bids" due to VA-requested forbearance. It should also be noted that a lender or holder may be suspended from obtaining guaranty or the right to the guaranty in respect to any loan made or purchased after the date of suspension whenever the lender or holder has failed to demonstrate proper ability to service loans.

Early reporting of defaults includes cases when the property is abandoned, the obligor advises no further payments will be made and any other cases when there is a possibility that a delay in termination may expose the security to waste or other hazard. Also, defaults by transferees on loans closed prior to March 1, 1988, should be reported to VA within 15 days after the loan becomes 2 months delinquent. In such cases, VA will authorize prompt termination action unless servicing develops a reason for forbearance.

When it appears that a default is insoluble, you should immediately file the notice of intention to foreclosure and the obligor should be provided with advice concerning alternatives to foreclosure, including the following:

a. Private Sale

(1) When foreclosure appears likely, it is generally advisable to recommend that the obligor attempt to sell the property privately in order to obtain any equity that may have accumulated. It will normally be prudent for you to postpone a foreclosure sale to allow the obligor time to effect such a sale, especially if a contract of sale has been signed.

(2) If there is little or no equity, the obligor should be made aware of the possibility of a compromise agreement and advised to keep VA informed as to any offers received for the property. The compromise is a partial claim paid to you for the difference between the mortgage indebtedness and the amount assumed, or between the offer and the amount required to satisfy the loan.

b. Deed in Lieu of Foreclosure. At the time you suggest a private sale, you should also recommend that the obligor consider offering a deed in lieu of foreclosure if efforts at a private sale are not successful. The obligor should be advised that acceptance of a voluntary conveyance will protect his or her credit rating and remove the possibility of becoming indebted to the Government. VA may approve such offers with or without payments from the obligor offsetting VA's estimated loss. Acceptance of deeds in lieu of foreclosure also reduces foreclosure costs, limits the potential for a decline in the value of the security and results in your guaranty claim and property acquisition being paid several months earlier than if foreclosure was completed.

c. Occupancy of the Property. Some obligors have intimated that they were advised by their loan holders to vacate the property prior to foreclosure -- sometimes several months prior to the foreclosure sale. While we question the accuracy of such statements, we wish to emphasize that it is in the best interests of all parties that the property remain occupied until the foreclosure sale. This will limit any potential vandalism to the property which may result from its remaining vacant for any period of time. Such vacant properties often decline in value at a faster rate than they would if they were occupied, leading to a greater potential for such cases to become "no-bids." In any event, it is the owner's legal right to occupy the property as long as he or she holds title. Remaining in the property also increases the possibility that an obligor's financial situation may improve to the point when arrangements can be made to reinstate the loan. Reinstatement potential is severely limited in cases when the property has been vacated. When you are advised that the property is or will soon be vacant, you should advise the obligor to rent out the property and apply the rental payments to reduce the amount due on the loan.

Sincerely yours,

LOAN GUARANTY OFFICER

TECHNICAL PROPOSAL
FOR
MORTGAGE INSURANCE PROGRAM
FEASIBILITY STUDY

TASK ORDER 08

for

Management Analysis and Studies

Contract No. V101 (93) P-1096

Prepared For:

Veterans Administration

810 Vermont Avenue

Washington, D.C. 20420

Prepared by:

Advanced Technology, Inc.

12001 Sunrise Valley Drive

Reston, VA 22091

VA MORTGAGE INSURANCE FEASIBILITY STUDY

Statement of Work

The contract involves the conduct of a feasibility study of various mortgage insurance options as a cost-effective veterans housing benefit. The need for such a study has been triggered by the heightened costs of the Veteran Administrations' guaranteed home loan program and the correspondingly large appropriations that have become necessary to support the Loan Guaranty Revolving Fund. The specific tasks which will be performed as part of the contract are set forth below.

Task One: Initial Meeting and Briefing

The Peat Marwick engagement team will meet with VA representatives to discuss each element of the contract and the feasibility study workplan so that there is a consensus concerning the objectives, approach, deliverables, and schedule associated with the study. Participating in this meeting will be Peat Marwick consulting professionals from both our insurance practice and our governmental practice. During this meeting we will also see to gain a thorough understanding of:

- the current Loan Guaranty Program:
- related issues, background information, and other relevant information which may have a bearing on the feasible opti at will be developed in Task Two and Task Three;
- the status of the VA's loan insurance program; and
- the source, nature and availability of statistical data associated with the VA home loan program.

We will also identify and gather data and information necessary for conducting the feasibility study, and to the extent particular information is not immediately available, work with VA representatives to identify our needs and develop a satisfactory plan for obtaining this information.

At the completion of this meeting, we will meet with VA Officials to present a summary of the objectives, workplan, deliverables and schedule associated with the feasibility study. Issues that surfaced during our meeting with VA representatives can also be discussed as appropriate.

We anticipate that the initial meeting will take place as soon as possible after receiving authorization to proceed with the contract, subject to the availability of all participants on a mutually agreed upon date. The briefing of VA Officials can be scheduled immediately following the initial meeting with VA representatives.

Task Two: Broad Outline of Insurance Options, Briefing and Written Report

Based on the data and information gleaned from our initial meeting with the VA, we will develop a number of mortgage insurance options which meet the VA's objectives as outlined in or initial meeting while at the same time maintaining the general characteristics of the GI home loan benefit program. Each option will be developed in broad outline, with out study addressing key issues including:

- o the general structure of the option;
- o the overall financial implications of the option (e.g., cashflow, reserving, actuarial soundness requirements, etc.);
- o key support requirements of the option (e.g. ADP, personnel, etc.); and
- o relationship with current VA guaranty program.

We will draw upon our knowledge of existing insurance loan programs within the VA and within other areas of government, as well as those operating in the private sector as a starting point for our analysis. In this regard, we do no anticipate the need to examine records in the VA's Chicago office in order to meet the objective of this task. Finally, we will summarize the relative advantages and disadvantages of each option so that the VA is best positioned to evaluate each option and make an informed decision regarding the most appropriate option.

Once Task Two is completed, we will meet with the VA and present our written report describing the structure, financial implications and support required for the various options and the relative advantages and disadvantages of each. We anticipate that Task Two and corresponding briefing can be completed within 45 work days (nine weeks) from the date of the initial meeting and briefing outlined in Task One.

Task Three: Detailed Description of Selected Option, Briefing and Written Report

Once the VA has selected a particular option, we will expand the broad outline of the option as defined in Task Two to address key elements in greater detail. In this regard, we anticipate that our emphasis will be on the following:

- o Structure - characteristics of the option, organization and operation, rules and responsibilities of each party, etc.;
- o Financial Implications - actuarial analysis of the range of premium rates composed to the current guaranty program, source of financing, nature and size of reserve funds, nature and size of other cost elements, financial responsibility of participants, solvency standards, general cash flow considerations, etc.;

- o Support Requirements - special ADP considerations, personnel requirements that may differ from that currently in place at the VA; etc. and
- o Effect on Current Guarantee Program - treatment of the Loan Guaranty Revolving Fund, transition program if necessary, impact on each program's participation levels, etc.

It is difficult to measure the scope and nature of the work required in Task Three until the particular option has been identified and the amount and suitability of the actuarial and related data is known. We assume that the selected option will encompass some combination of structure, financial implications, support requirements and transition elements that are in line with currently existing governmental or private sector programs and that adequate data will be available. To the extent we develop an option that is ultimately selected by the VA which departs considerably from any program currently in existence and correspondingly requires a greater degree of explanation and documentation, (or if data issues create unanticipated difficulties) we will be aware of this at the completion of Task Two and would be prepared to discuss the scope and nature of the work required to complete Task Three during our Task Two briefing with VA officials.

Subject to the limitations described above, we anticipate that we can complete Task Three and meet with the VA to present our written report within 75 work days (15 weeks) from the time we are informed by the VA of the particular option arising from Task Two that they have selected.

Schedule

Based on the statement of work as described above, we are prepared to provide the deliverables associated with Task One, Task Two and Task Three in accordance with the schedule set forth below. In this regard, we recognize the written reports presented at briefings will serve as draft versions to be finalized to encompass VA comments. In this regard, the VA has indicated that there will be a two week interval in which to prepare their comments, and the contractor will have one week in which to produce a final report.

Item	Delivery Date
Task One (Initial Meeting) Deliverable One (Briefing)	First mutually agreeable date after award
Task Two (Broad Options) Deliverable Two (Briefing, Report)	45 workdays (9 weeks) after Task One Briefing
Task Three (Detailed Option) Deliverable Three (Briefing, Report)	75 workdays (15 weeks) after notification from VA of selected option

MANAGEMENT APPROACH

To insure that the technical approach discussed in Section 2.0 can be achieved, Advanced Technology will apply its management approach, which has been tested successfully in many tasks of similar scope and requirements. This approach consists of the following elements:

- Management Objectives ,
- Management Organization ,
- Task Deliverable Schedule , and
- Reporting Procedures .

Management Objectives

The Task Manager will direct and manage the tasks to insure that the following objectives are met:

- Technical accuracy in all products which will fully satisfy VA's technical requirements;
- All products delivered on schedule and within budget; and
- A formal as well as informal communication process with the TOPM and other key VA staff to ensure that VA's objectives are met at each stage of the task and that they are fully informed on issues, problems and proposed solutions during the conduct of the task.

Management Organization

Advanced Technology, Inc., as the prime contractor to the Veterans Administration, will provide the overall direction for this project. Advanced Technology will assign Mr. John Fassanella as the Project Manager. He will be responsible for overall project management, quality assurance, preparation of all technical input to ATI contracts, preparation of all technical reporting required on the task, input to and review of all draft and final deliverables, the technical base of operations for remote field staff, and direction of the subcontractor, Peat Marwick . The KPMG team will be led by the Peat Marwick Task

Manager, David Wassermanf, who will be assisted by Linda Simmons and David Bialzak.Advanced Technology, Inc. understands the VA commitment to having distinctly qualified personnel be available to assist in this study. We will continue to work with the VA to assure that the best available personnel, who meet or exceed the qualifications, will be offered to the VA for this task. Personnel resumes for these individuals are presented in this document.

Advanced Technology

April 29, 1988
00157

Ms. Marilyn Martin
Contract Specialist
Veterans Administration
Office of Procurement and Supply (93A-4)
Room 767
810 Vermont Avenue, N.W.
Washington, D.C. 20420

Reference: Contract No. V101(93)P-1096; Task Order 8

Subject: Technical and Cost Proposal Submission

Dear Ms. Martin:

Pursuant to your Statement of Work dated April 15, 1988; Advanced Technology, Inc. is pleased to submit its technical and cost proposals for Task Order 8 under the referenced contract.

If you have any questions or need additional information, please contact me at (703) 620-8516.

Sincerely,

ADVANCED TECHNOLOGY, INC.
Jan L. Kucheruk

Jan L. Kucheruk
Contracts Administrator

JLK/lrc

Enclosures

TASK ORDER

Contractor: Advanced Technology Inc. Contract No. B101(93)P-1096

Client Agency: VETERANS ADMINISTRATION CENTRAL OFFICE

Project Name: Feasibility Study of Mortgage Insurance Program Task Order No. 8

* * *

Section I - TASK REQUEST. Submit your technical and cost proposal (SF-1411) in an original and two copies to accomplish this Task Request to the VA Contracting Officer by COB April 11, 1988. The original should not be bound unless in looseleaf style to facilitate the insertion of revised pages during negotiations. Specifications and requirements are attached. Your cost porposal must be on a fixed price basis using the rates as contained in the schedule of the referenced contract. This price will include all associated costs relating to this task including travel beyond the local area if required.

Submitted by: MariLyn A. Martin Date: 3/25/88
VA Contracting Officer

**THIS TASK ORDER FORM MUST BE SIGNED IN ORIGINAL AND RETURNED WITH YOUR PROPOSAL.

* * *

Section II - TASK ORDER PROPOSAL. Attached is a technical and cost proposal (SF 1411) to accomplish this task.

SCHEDULE: Completion will be Tasks 1&2 50work days after receipt of the task order authorization.

TOTAL COST: The total amount required to complete this task order is $55,645. This price is supported by the attached price proposal (SF 1411).

Submitted by: Linda M. Rauner
NAME
Director of Contract Management
Linda M Rauner April 29, 1988
SIGNATURE DATE

* * *

****

Section III - TASK ORDER AUTHORIZATION. Resources, costs, plans, and schedules outlined in your proposal dated ______________ as amended on ______________ are approved. Work to accomplish this Task Order is authorized.

1. Schedule: Start: ________ Final Completion: ________ Total Days: __________

Appropriation No. ______________________
____

Obligation No. __________-__________

Final Price: ______________________

Approved By: ______________________________ Date: __________
VA Contracting Officer

****

Section IV - TASK ORDER COMPLETION AND ACCEPTANCE.

1. Contractor Certification. Deliverables are completed according to specifications.

By: ______________________________ Date: ____________________
Contractor Representative

2. Client Agency Acceptance. Deliverables are complete and are acceptable as of:

By: ______________________________ Date of completion: ______________
VA Project Manager

3. Project was:

Completed on: __________. On Time (____). Late (____). Days late ___

By: ______________________________ Date: ____________________
VA Contracting Officer

****

STATEMENT OF WORK

FEASIBILITY STUDY OF MORTGAGE INSURANCE PROGRAM

A. GENERAL OBJECTIVES AND REQUIREMENTS

1. Title of Project: Feasibility study of mortgage insurance options as a veterans housing benefit.

2. Authority for the Project: Subpart 37.2 of 48 CFR prescribes policies and procedures for acquiring consulting services by contract, and regulates these contracts with individuals and organizations for both personal and nonpersonal services.

3. Purpose of Contract: Loan Guaranty Service wishes assistance in conducting a feasibility study of various mortgage insurance options as a cost-effective veterans housing benefit.

4. Background:

Insurance is defined as "the act, system, or business of insuring property, life, one's person, etc., against loss or harm, in consideration of a payment proportionate to the risk involved." Mortgage insurance is that insurance which protects the lender from some degree of loss in case the buyer defaults on his obligations and the value of the security does not cancel the debt. One of the primary purposes of mortgage insurance is to substitute insurance for part or all of the downpayment, for the protection of the lender.

The Veterans Administration has for many years conducted a guaranteed home loan program, as a benefit for veterans. In 1945 Congress also created a loan insurance plan that might be employed as an alternative to the VA loan guaranty plan by supervised lenders. Because VA's insurance was a benefit to returning veterans no premiums were charged to fund a reserve to cover losses. Instead, losses were paid for by the U.S. Treasury. This program was not widely used by lenders, with less than 20,000 home loans ever insured, compared to over 12 million loans guaranteed. A large percentage of the insured loans was made through one VA office (Chicago). Although the program is still on the books, the last VA insured loan was made in 1973.

The Federal Housing Administration (FHA) has a widely used mortgage insurance program, targeted at moderate income home buyers. There are at least two basic differences between the GI home loan and an FHA home loan: the most basic difference is that the GI home loan was seen as a benefit given to returning veterans as thanks from a grateful nation, and so the cost of the guaranty or insurance has been borne by the taxpayers; secondly, the GI home loan was designed to be a no-downpayment loan, on the presumption that returning veterans had lacked the opportunity during military service to accumulate money for a downpayment.

Between 1934 and 1957, the only mortgage insurance available to home buyers was government sponsored (FHA or GI). In 1957 a privately owned business venture was founded to offer private mortgage insurance (PMI). Today about a dozen firms offer private mortgage insurance.

Because of the large appropriations necessary in recent years for the Loan Guaranty Revolving Fund (to support the guaranty program), the VA now needs to reexamine the possibility of offering mortgage insurance to veterans as a housing benefit. Topics which must be explored include the design of a viable insurance program which maintains its status as a veterans benefit, the premiums which would have to be charged, who would pay them, the size of a reserve which would be necessary, the total costs of the program, etc.

5. Scope and Methodology:

a. The contractor shall conduct a feasibility study which shall first develop, in broad outline, at least three different approaches to a mortgage insurance program for veterans, with roughly estimated costs and reserve requirements.

b. Upon approval by VA, the contractor shall develop in detail the option chosen by VA, including actuarial analyses, an estimate of premiums which would have to be charged, who would pay them, the size of a reserve which would be necessary, the total costs of the program, the effect implementation of such a program would have on the existing obligations of the Revolving Fund, etc. Consideration must be given to the fact that any such program should maintain the characteristics of the GI home loan benefit program.

c. Contractor shall be expected to meet with Loan Guaranty staff as necessary, and manipulate Loan Guaranty data bases using their own resources. Primary expertise needed is an understanding of the mortgage insurance industry, actuarial estimating procedures, and government benefit programs.

B. TASKS AND ASSOCIATED DELIVERABLES

1. Term of Contract: The work required under this task order must be completed within six months, i.e., 126 workdays (Monday through Friday, exclusive of Federal Holidays) from the date of award.

2. Description of Tasks and Associated Deliverables: To support the purposes of Loan Guaranty, the contractor shall, at a minimum, complete the following tasks:

2.1. Task One: Conduct initial meeting with VA representatives, to discuss the contract, receive an initial orientation to the Loan Guaranty Program, and identify sources of statistical and background information.

Deliverable One: A briefing for VA Officials. The contents of this briefing shall be consistent with the contractor's technical proposal and detailed workplan.

2.2. Task Two: The contractor shall conduct a feasibility study which shall first develop, in broad outline, at least three different approaches to a mortgage insurance program for veterans, with roughly estimated costs and reserve requirements. Contractor shall visit Chicago VARO to examine records of existing VA insured loans, and will address in the study whether and how the outstanding insured loans should be integrated into any new ADP system set up for a new insured loan program. This study shall be submitted to VA for review.

Deliverable Two: A briefing and written report describing at least three insurance options.

2.2.1. Task Two A: Upon selection of one option by VA, contractor shall provide cost estimate and if necessary a new work plan for Task Three.

Deliverable Two A: cost estimate, and new work plan if necessary.

* * *   * * *

d. Cost estimate and work plan (Task 2A and Deliverable 2A)	Ten copies to TOPM, plus one courtesy copy each to COTR and Contracting Officer	60 workdays after award

2.3. Task Three: Upon approval by VA, the contractor shall develop in detail the option chosen by VA, including actuarial analyses, an estimate of premiums which would have to be charged, who would pay them, the size of a reserve which would be necessary, the total costs of the program, the effect implementation of such a program would have on the existing obligations of the Revolving Fund, etc. Consideration must be given to the fact that any such program should maintain the characteristics of the GI home loan benefit program.

Deliverable Three: A briefing and written report detailing the research and findings of Task 3.

3. Schedule of Deliverables: The following items shall be delivered in accordance with the schedule indicated. If the contractor believes that different dates should be established, these proposed dates will be indicated in the technical proposal and/or detailed work plan. Because of the nature of this project, camera-ready masters of deliverables are either not applicable or not desired. In respect to Deliverables Two and Three, delivery dates pertain to draft versions. Thereafter, the VA will have two weeks in which to prepare consolidated Agency comments and provide same to the contractor. Thereafter, contractor will have one week in which to produce the final version of these deliverables.

	ITEM	QUANTITY	DELIVERY
a.	Conduct Initial meeting (T [illegible]) and Delive[illegible])	NA	Within 5 workdays after award
b.	Briefing and written report (Task 2 and Deliverable 2)	Ten copies to TOPM, plus one courtesy copy each to COTR and Contracting Officer	50 workdays after award
c.	Briefing and written report (Task 3 and Deliverable 3)	Ten copies to TOPM, plus one courtesy copy each to COTR and Contracting Officer	126 workdays after award

4. Reporting Requirements: Changes to the original statement of work will be documented and approved only through written correspondence between the VA Contracting Officer and the contractor. A copy of each change will be kept in the project folder along with all other products of the project. Because of the short timeframe of this task order, the contractor will not be required to provide written progress reports, but will be required to meet weekly with the TOPM and other designated Loan Guaranty officials to discuss the direction and progress of this project.

CONTRACT PRICING PROPOSAL COVER SHEET

1. SOLICITATION/CONTRACT/MODIFICATION NO. V101(93)P-1086

FORM APPROVED OMB NO. 3090-0116

NOTE: This form is used in contract actions if submission of cost or pricing data is required. (See FAR 15.804-6(b))

2. NAME AND ADDRESS OF OFFEROR (Include ZIP Code)

Advanced Technology, Inc.
12005 Sunrise Valley Drive
Reston, Virginia 22091

3A. NAME AND TITLE OF OFFEROR'S POINT OF CONTACT

Jan L. Kucheruk
Contracts Administrator

3B. TELEPHONE NO. 703-620 3516

4. TYPE OF CONTRACT ACTION (Check)

☐ A. NEW CONTRACT
☐ B. CHANGE ORDER
☐ C. PRICE REVISION/ REDETERMINATION
☐ D. LETTER CONTRACT
☐ E. UNPRICED ORDER
☒ F. OTHER (Specify) Delivery order

5. TYPE OF CONTRACT (Check)

☒ FFP ☐ CPFF ☐ CPIF ☐ CPAF
☐ FPI ☐ OTHER (Specify)

6. PROPOSED COST (A+B=C)

A. COST $
B. PROFIT/FEE $
C. TOTAL $ 55,645

7. PLACE(S) AND PERIOD(S) OF PERFORMANCE

Reston, VA and Washington, D.C. Tasks 1&2 50 workdays after award

8. List and reference the identification, quantity and total price proposed for each contract line item. A line item cost breakdown supporting this recap is required unless otherwise specified by the Contracting Officer. (Continue on reverse, and then on plain paper, if necessary. Use same headings.)

A. LINE ITEM NO.	B. IDENTIFICATION	C. QUANTITY	D. TOTAL PRICE	E. REF.
	Task Order No. 8 Feasibility Study of Mortgage Insurance Program	HOURS 797	AMOUNT $55,645	SEE ATTACHED

9. PROVIDE NAME, ADDRESS, AND TELEPHONE NUMBER FOR THE FOLLOWING (If available)

A. CONTRACT ADMINISTRATION OFFICE

DCASMA, Baltimore
300 East Joppa Road
Towson, Maryland 21204
(301) 321-4940

B. AUDIT OFFICE

CAA - Mid Atlantic Region
on Branch Office
20 Century Boulevard, Suite 102
Germantown, Maryland 20874-1143
(301) 428-1588

10. WILL YOU REQUIRE THE USE OF ANY GOVERNMENT PROPERTY IN THE PERFORMANCE OF THIS WORK? (If "Yes," identify)

☐ YES ☒ NO

11A. DO YOU REQUIRE GOVERNMENT CONTRACT FINANCING TO PERFORM THIS PROPOSED CONTRACT? (If "Yes," complete Item 11B)

☐ YES ☒ NO

11B. TYPE OF FINANCING (✓ one)

☐ ADVANCE PAYMENTS ☐ PROGRESS PAYMENTS
☐ GUARANTEED LOANS

12. HAVE YOU BEEN AWARDED ANY CONTRACTS OR SUBCONTRACTS FOR THE SAME OR SIMILAR ITEMS WITHIN THE PAST 3 YEARS? (If "Yes," identify item(s), customer(s) and contract number(s))

☐ YES ☒ NO

13. IS THIS PROPOSAL CONSISTENT WITH YOUR ESTABLISHED ESTIMATING AND ACCOUNTING PRACTICES AND PROCEDURES AND FAR PART 31 COST PRINCIPLES? (If "No," explain)

☒ YES ☐ NO

14. COST ACCOUNTING STANDARDS BOARD (CASB) DATA (Public Law 91-379 as amended and FAR PART 30)

A. WILL THIS CONTRACT ACTION BE SUBJECT TO CASB REGULATIONS? (If "No," explain in proposal)

☒ YES ☐ NO

B. HAVE YOU SUBMITTED A CASB DISCLOSURE STATEMENT (CASB DS-1 or 2)? (If "Yes," specify in proposal the office to which submitted and if determined to be adequate)

☒ YES ☐ NO DCASMA, Baltimore

C. HAVE YOU BEEN NOTIFIED THAT YOU ARE OR MAY BE IN NONCOMPLIANCE WITH YOUR DISCLOSURE STATEMENT OR COST ACCOUNTING STANDARDS? (If "Yes," explain in proposal)

☐ YES ☒ NO

D. IS ANY ASPECT OF THIS PROPOSAL INCONSISTENT WITH YOUR DISCLOSED PRACTICES OR APPLICABLE COST ACCOUNTING STANDARDS? (If "Yes," explain in proposal)

☐ YES ☒ NO

This proposal is submitted in response to the RFP contract, modification, etc. in Item 1 and reflects our best estimates and/or actual costs as of this date.

15. NAME AND TITLE (Type)

Linda M. Rauner
Director of Contract Management

16. NAME OF FIRM

ADVANCED TECHNOLOGY, INC.

17. SIGNATURE

Linda M Rauner

18. DATE OF SUBMISSION

April 29, 1988

NSN 7540-01-142-9845

1411-101

☆ U.S. GOVERNMENT PRINTING OFFICE : 1984 0 - 421-526 (37)

STANDARD FORM 1411 (10-83)
Prescribed by GSA
FAR (48 CFR) 53.215-2(c)

ADVANCED TECHNOLOGY, INC.
APRIL 29, 1988

TASK ORDER NO. 8 FEASIBILITY STUDY OF MORTGAGE INSURANCE PROGRAM

TASK 1: INITIAL MEETING

SKILL LEVEL	RATE	HOURS	AMOUNT
IV(ATI)	50.67	8	405
III(ATI)	40.24	0	0
II(ATI)	30.81	0	0
I(ATI)	16.88	0	0
IV(PMR)	101.57	16	1,625
III(PMR)	58.28	8	466
II(PMR)	51.56	0	0
I(PMR)	15.01	0	0
SUBTOTAL		32	2,497
OTHER DIRECT COSTS		0	
G&A @ 16.0%		0	
FEE @ 9.0%		0	
TOTAL		2,497	2,497
SUBCONTRACTOR		2,091	
FICOM @ 3.8%		79	
SUBTOTAL		2,171	
FEE @ 9.0%		195	
TOTAL FICOM AND FEE		275	275
TOTAL TASK 1			2,772

TASK 2: BROAD OPTIONS

SKILL LEVEL	RATE	HOURS	AMOUNT
IV(ATI)	50.67	40	2,027
III(ATI)	40.24	0	0
II(ATI)	30.81	0	0
I(ATI)	16.88	20	338
IV(PMR)	101.57	240	24,377
III(PMR)	58.28	235	13,696
II(PMR)	51.56	70	3,609
I(PMR)	15.01	160	2,402
SUBTOTAL		765	46,448
OTHER DIRECT COSTS		500	
G&A @ 16.0%		80	
FEE @ 9.0%		52	
TOTAL		47,080	47,080
SUBCONTRACTOR		44,083	
FICOM @ 3.8%		1,675	
SUBTOTAL		45,759	
FEE @ 9.0%		4,118	
TOTAL FICOM AND FEE		5,793	5,793
TOTAL TASK 2			52,873

TOTAL TASKS 1 AND 2

SKILL LEVEL	RATE	HOURS	AMOUNT
IV(ATI)	50.67	48	2,432
III(ATI)	40.24	0	0
II(ATI)	30.81	0	0
I(ATI)	16.88	20	338
IV(PMR)	101.57	256	26,002
III(PMR)	58.28	243	14,162
II(PMR)	51.56	70	3,609
I(PMR)	15.01	160	2,402
SUBTOTAL		797	48,945
OTHER DIRECT COSTS		500	
G&A @ 16.0%		80	
FEE @ 9.0%		52	
TOTAL		49,577	49,577
SUBCONTRACTOR		46,175	
FICOM @ 3.8%		1,755	
SUBTOTAL		47,929	
FEE @ 9.0%		4,314	
TOTAL FICOM AND FEE		6,068	6,068
TOTAL TASK 1 AND TASK 2			55,645

DELIVERABLE PAYMENT SHCEDULE

TASK 1	2,772	5 WORKDAYS AFTER AWARD
TASK 2	52,873	45 WORKDAYS AFTER TASK 1 BRIEFING
TASK 3	TBD	TBD

If, for any reason, any deliverable cannot be provided within the scheduled time frame, the contractor is required to submit a request for a time extension to the Contracting Officer. This request will cite the reasons for the delay, the impact on the overall project, and the impact on the cost of this task, either increased or decreased. The Contracting Officer will consider each request on the basis of its merits and will, if appropriate, issue a modification to the task order. The contractor is required to proceed as scheduled until such modification is issued. The contractor shall have the right of appeal under the disputes clause if the request for extension is denied.

C. GUIDANCE CONSIDERATION FOR FINDINGS AND RECOMMENDATIONS

The contractor will consider the effect of the data and information collected and presented in this effort in terms of the following factors:

1. Utility as a basis for decision-making by Loan Guaranty and VA management.

2. Assurance of cost effective use of VA resources.

3. Objective validity and verifiability of assumptions and projections.

4. Practicality and/or relative ease of use.

5. Consistency with commonly used, sound, budgetary and management principles and practices.

D. CONFIDENTIALITY AND NONDISCLOSURE

It is agreed that:

1. The preliminary and final deliverables and all associated working papers and other materials deemed relevant by VA which have been generated by the contractor in the performance of this task order are the property of the U.S. Government.

2. The Administrator of Veterans Affairs or his authorized designee will be the sole authorized official to release verbally or in writing any data, deliverables, or any other written or printed materials pertaining to this task. No information will be released by the contractor. Any requests for information relating to this task presented to the contractor will be submitted to the Veterans Administration for response.

Contract Number V101(93)P-1097

Proposal for

Validation of the Loan Guaranty Budget Process

Task Order No. 7

Booz•Allen & Hamilton Inc.

May 5, 1988

BOOZ·ALLEN & HAMILTON INC.

4330 EAST WEST HIGHWAY • BETHESDA, MARYLAND 20814-4455 • TELEPHONE: (301) 951-2200 • TELEX II 710-824-0552

April 22, 1988

Marilyn Martin
Office of Procurement
and Supply (93A)
Veterans Administration
Room 767
810 Vermont Ave., N.W.
Washington,. DC 20420

Dear Marilyn:

Based on our discussions with Loan Guaranty staff on May 2 we have made changes in our proposal for Validating the Loan Guaranty Budget Process. As requested, we have focused our attention on the development of a computerized model for predicting revenues to and claims against the Loan Guaranty Revolving Fund rather than a more comprehensive model for predicting all Loan Guaranty program budget requirements. The predictor variables that will be used in developing the model will be limited to those that can be obtained from data readily available to the VA through existing information systems or the Office of Management and Budget. The model will provide information at the national and regional levels but will not provide state-level information as originally proposed.

We look forward to working on this important project. Please contact me at (301) 951-2918 if you have any questions about the changes we have made.

Sincerely,

BOOZ•ALLEN & HAMILTON Inc.

Daniel Swedberg
Senior Associate

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I. BACKGROUND AND UNDERSTANDING

This chapter describes Booz, Allen's understanding of the purpose of the proposed project. Our understanding is based upon background knowledge of the overall mission, organization and responsibilities of the Loan Guaranty Service. The first section of this chapter describes this background. Next, we describe the budget request process and identify factors key to the development of the budget. This chapter concludes with a discussion of our understanding of the study objectives.

1. BACKGROUND

The Department of Veterans Benefits (DVB) administers a comprehensive array of non-medical benefit programs for veterans, their dependents and their survivors. One of the larger and more dynamic programs operated by the DVB is the Veterans Administration's (VA's) home loan program which assists veterans finance the purchase of homes with favorable loan terms. This program provides credit assistance to eligible veterans, active duty service persons, and certain surviving spouses seeking to buy, build, refinance or repair a home, condominium or mobile home. The guarantee may be made up to 60 percent of the loan or $27,500, whichever is less. In the event of foreclosure, the VA will pay the outstanding balance due on the loan to the lender, and costs incurred through foreclosure, up to the amount of the guarantee. The determination of whether or not the VA acquires the foreclosed property is based on the "net" value to the Government of acquiring the property or paying the claim. Another program administered by the VA is the Specially Adapted Housing (SAH) Program which provides funds for up to 50 percent of the acquisition costs of a SAH unit to a maximum limit of $35,500.

The Loan Guaranty Services in the DVB Central Office formulates policies, plans, procedures and budgets for the effective administration of the VA home loan program and the Specially Adapted Housing Program. The Loan Guaranty Service also provides management support and guidance to the 49 DVB regional offices in their day-to-day provision of loan guaranty services to veterans.

The DVB regional offices administer the home loan and housing programs through a loan guaranty division which is typically divided into four functional groups, each concentrating on one aspect of the program. The groups and their responsibilities include:

- Construction and Valuation Group--Responsible for the determination of the reasonable value of properties for a VA loan in accordance with program requirements

- Loan Processing Group--Responsible for the determination or restoration of Veterans' loan entitlement benefits and the issuance of certificates of commitment to lenders stating that the VA will guarantee a certain percent of the loan issued.

- Loan Services and Claims Group--Responsible for the management of those VA loans where lenders have issued a notice of default. Also responsible for working with the Veterans to handle the liquidation of security and the disposition of liabilities.

- Property Management Group--Responsible for the management of the disposition and maintenance of VA acquired properties while attempting to recapture as much of the Government's investment as possible.

Workload data for all regional offices is systematically collected and reported on a monthly basis as part of the DVB Productivity Measurement System. Detailed data are captured through the four basic loan guaranty management information systems:

- Guaranteed/Insured Loan System (GIL)
- Liquidation Claims System (LCS)
- Property Management System (PMS)
- Portfolio Loan System (PLS).

The workload data is categorized into nineteen end products or output measures of the loan guaranty division.

2. BUDGET REQUEST

Each year the DVB program offices such as the Loan Guaranty Service participate in the budget formulation process which begins in February with a request for program assumptions, is formalized at the beginning of June with the DVB budget submission to the VA Controller and is continually assessed until the submission to OMB for inclusion in the President's Budget. Both the program offices and the DVB regional offices submit assumptions about projected workloads. Program estimates of projected workload and required staffing are developed for a five year period beginning with the current fiscal year. The required staffing levels are determined through the application of the DVB Productivity Measurement System based upon forecasted workload and the expected productivity index of the workforce.

The Loan Guaranty Service is required to provide estimates not only for workload and required staffing, but also for the Loan Guaranty Revolving Fund which is authorized under 38 U.S.C. 1824 to finance all operations of the Loan Guaranty program except for administrative costs. Key workload elements such as appraisal requests, loans guaranteed, defaults on outstanding loans, foreclosures, and properties acquired, managed and sold impact the obligations and receipts of the Revolving Fund. At the present time, no formal model exists for the purposes of estimating the budget requirement for the Loan Guaranty Service. A systematic methodology is employed, but this methodology has not yet been formalized into a predictive model.

3. PROJECT PURPOSE

Valid budget estimates are essential to the fulfillment of the overall mission of DVB. The specific budget requirements of the loan guaranty program are influenced by numerous, diverse and dynamic factors, such as the size and nature of the veteran population, the unemployment rate, interest rates, local economic conditions and housing markets, just to mention a few. The delineation of these specific variables and the determination of their predictive value is an important requirement for developing valid budget estimates for the loan guaranty program.

The primary purpose of this project is to develop a computerized model that will predict revenues to and claims against the Loan Guaranty Revolving Fund and necessary documentation and training. While the model will provide the capability to project at a regional level (approximately 4-6 regions), its primary purpose will be to develop national level projections of Fund requirements. Input variables for running the model will be limited to those available from internal VA data and from macro-economic data provided by the Office of Management and Budget (OMB). Output from the model will be used by the Loan Guaranty program to identify revolving fund requirements during the budget process. It is anticipated that the model will also provide a tool for projecting key workload variables required in projecting GOE requirements and for identifying the effects on Fund requirements of changes in the funding fee.

II. METHODOLOGY OVERVIEW

This chapter provides an overview of our methodology for the development of a predictive model. Our approach to this project can be categorized into two major phases. These are model development, and automation and installation of the model at the DVB In this section we will discuss methodological issues associated with each phase of the project.

1. MODEL DEVELOPMENT

Successful achievement of the project objectives requires that the statistical model used be appropriate to the problem, that all of the major factors that affect the Loan Guaranty Fund be taken into consideration, and that accurate and reliable data sources be used in estimating key relationships. Issues key to model development include the identification of predictive variables, the identification and assessment of data sources, the level of aggregation of the analysis, and the analytical techniques employed.

(1) The Identification of Predictive Variables

The baseline for the identification of factors that impact the Revolving Fund will be the current methodology. Additional demographic and economic factors will be identified based upon discussions with DVB personnel and a brief literature review of the mortgage banking industry. It may also be useful to check with the Federal Housing Administration (FHA) to determine whether they have conducted similar modelling exercises with respect to their no-down-payment loan guaranty program.

Some end products (i.e., model outputs) will be identified as predictive variables for other analyses. For example, the model's prediction of the number of loans issued may be used in combination with economic and demographic factors to predict the number of foreclosures in future years. Thus, the accuracy of forecasting foreclosures is dependent upon the accuracy of predicting the number of loans issued. In addition, there may be a lag factor associated with some of the relationships among end products in that the workload of one end product during one year may not impact another until two or three years later. The identification of predictive factors also includes the operationalization of those factors into quantitative variables.

(2) The Identification and Assessment of Data Sources

Once the key variables needed have been specified, data sources must be identified and assessed. Specifically, we will need to obtain historical data on loan originations and cancellations, as well as other elements that affect the level of expenditures from the Loan Guaranty Revolving Fund. Secondly, we will need to obtain historical data series on economic performance measures that are related to program perfvormance, such as unemployment rates, housing price deflators, mortgage interest rates, and housing starts.

(3) Geographic Level of Aggregation

To obtain an acceptable level of accuracy, it will probably be necessary to model the relationships between external variables and program performance variables at a regional level. A regional approach will expand, and to some extent, complicate data collection efforts, but should substantially improve the accuracy and usefulness of the results.

(4) The Analytical Techniques

Choice of the appropriate analytical technique in a multivariate analysis is critical to accurate estimation of statistical relationships. In most cases, we will employ multiple regression (ordinary least squares) as an analytical technique to estimate relationships between external variables and program performance data. Some examples of key relationships that will need to be estimated include the following:

Predicted Variable	Candidate Predictor Variables
1. Number of loans originated	- number of eligible veterans - VA interest rate - conventional mortgage interest rate - unemployment rate

	- number of housing starts
2. Number of cancellations	- number of loans originated in - previous five years - conventional interest rate - past VA interest rates - unemployment rate - inflation rates during recent years
3. Number of houses in DVB inventory	- number of cancellations - interest rates - number of housing starts - unemployment rate

As the above sample list of relationship illustrates, program performance variables (end products) are interrelated in a sequential fashion, with downstream variables (e.g. cancellations) determined partially by upstream variables (e.g loan originations). Secondly, estimation of the model is complicated by the [illegible]e of lagged variables. For example, the probability of a default on a given individual loan will presumably be influenced not only by the ijnflation rate during the past year, but also the inflation rate during every year since the loan was originated. We will deal with this type of phenomenon by creating a series of lagged variables, which should help us improve the accuracy of the model.

2. AUTOMATION AND INSTALLATION OF THE MODEL AT THE VETERANS ADMINISTRATION

The utility of the budget model will depend to a great degree upon the model implementation approach employed. Factors key to this success include the automation of the model, the documentation of the model, and training personnel to apply the model.

(1) Automation of the Model

A key issue in model automation is the selection of appropriate software. Our current thinking is that a spreadsheet program such as LOTUS 1-2-3, will be the most convenient type of approach for VA personnel.

The budget model must be automated in a manner that is "user-friendly" and easily updateable. A menu-driven program will be developed to facilitate ease of application. Key parameters of the model will be organized so as to permit easy access for any modifications of the model.

(2) Documentation of the Model

A model may be comprehensive, accurate, and easy to apply, yet fall short of success due to a lack of user understanding about its assumptions and algorithms. We will provide a well-organized and easily followed guide to the model delineating all assumptions, along with the basis or justification for the assumptions, and describing all model variables and data sources. In addition, a special section explaining procedures for updating model parameters will be provided.

(3) Training Personnel

Effective training is key to the successful application of the budget model. We will provide training on the basics of the model, supplemented with "hands-on" activities with Loan Guaranty personnel as they apply the model. Material used in these efforts will be provided to DVB for its own future training efforts.

III. TASK PLAN

This chapter presents our plan for accomplishing tasks associated with this project. The tasks generally follow those identified by the VA in its Statement of Work. Minor changes have been made in the timing of those tasks and some interim deliverables to allow us to more efficiently carry out the overall assignment. The task schedule presented in Exhibit III-1 indicates a total duration of approximately 100 work days. Activities required to carry out assignment tasks and subtasks are described in the remainder of this chapter.

1. TASK 1: FINALIZE DETAILED METHODOLOGY

The purpose of this task is to finalize the methodology we will use to develop and estimate the model. This task will require approximately one week and will include discussions with loan guaranty personnel and the identification and assessment of data sources. The result of this task will be a refined methodology for DVB approval.

(1) Subtask 1.1: Initial Orientation to the Loan Guaranty Program

This first subtask will involve meetings and discussions with loan guaranty personnel to obtain basic background information on the loan guaranty program and factors that affect the Loan Guaranty Fund. We will flowchart each chain of program end products that lead to drawdowns against the Fund.

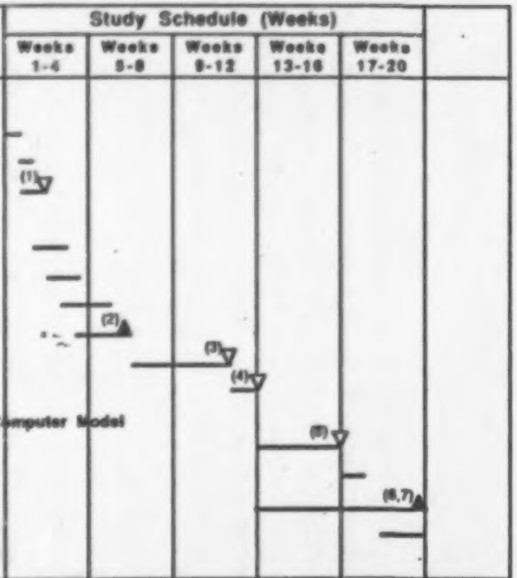
(2) Subtask 1.2: Review Existing Data Sources

During this subtask we will work with loan guaranty personnel to identify various sources of data used in past budget formulations and any other potential data which may be used to predict revenues to and claims against the Fund We will be sensitive to the data availability issue as we assess various data sources given the limited resources available for budget preparation. This task will provide us with a good understanding of the data available for use in the model.

Exhibit III-1
PROJECT TASK PLAN

Tasks/Subtasks

1. Finalize Detailed Methodology
    - 1.1 Initial Orientation to Loan Guaranty Program
    - 1.2 Review Existing Data Sources
    - 1.3 Recommend Detailed Methodology
2. Development and Validation of Loan Guaranty Model
    - 2.1 Review Current Methodology
    - 2.2 Modify Current Methodology
    - 2.3 Historical Analysis
    - 2.4 Specification of Model
    - 2.5 Application of Model
    - 2.6 Refinement of Model
3. Development, Application and Institutionalization of Loan Guaranty Computer Model
    - 3.1 Development of LOTUS Program for Budget Model
    - 3.2 Test and Debug Model
    - 3.3 Develop Model Documentation
    - 3.4 Train VA Users



Staff Loading (Hrs)		Weeks 1-4	Weeks 5-8	Weeks 9-12	Weeks 13-16	Weeks 17-20	Total
	Senior Professional	129	144	100	84	84	541
	Junior Professional	240	320	273	160	160	1153
	Clerical				8	40	48
	TOTAL STAFF HOURS	369	464	373	252	284	1,588

▽ Briefing
▲ Report/Documentation

Study Deliverables

(1) Final Study Methodology Briefing
(2) Specification of Methodology and Model - Report
(3) Application of Model for Five Year Budget Projections - Briefing
(4) Refinement of Model - Briefing
(5) Briefing on LOTUS Computer Model
(6) Model Documentation
(7) Four Copies of Model on PC-Co) Diskettes

(3) Subtask 1.3: Recommend Detailed Methodology

Based upon knowledge and insights gained through discussions with loan guaranty personnel, and the review and assessment of existing data sources, we will recommend the most appropriate methodology for the development of the model.

2. TASK 2: DEVELOPMENT AND VALIDATION OF LOAN GUARANTY BUDGET MODEL

The purpose of this task is to develop and validate a budget preparation methodology and model for estimating the loan guaranty GOE, funding fee and Revolving Fund.

(1) Subtask 2.1: Review Current Methodology

To accomplish this subtask, we will meet with loan guaranty personnel to discuss the current methodology used to develop loan guaranty budget estimates.with respect to the Revolving Fund. In addition, we will review all available documentation for the budget submissions and estimates for the past five years. We will develop a model concept, and will meet with the client to discuss the concept before proceeding further to develop the model. The concept paper will include data elements and sources, specific analytical techniques, suggested software, and system reports.

(2) Subtask 2.2: Data Collection and Entry

Once the model concept has been approved, we will begin collection of program performance data from DVB sources and historical economic performance data. Based on our understanding that most of the data that we will require will probably be provided only in hard copy, we are allocating substantial resources to this task.

(3) Subtask 2.3: Estimation of Statistical Relationships

During this subtask, we will apply the modified methodology to historical data to delineate predictive variables for workload and the Revolving Fund. We will use multiple regression to explain the variation in workload and the Revolving Fund for various time periods of the past. In the case of workload indicators, we will assess the predictive value of various economic and demographic indicators. In the case of the Revolving Fund, we will assess the predictive value of various workload indicators in combination with selected economic indicators.

(4) Subtask 2.4: Construction of the Model

Based upon the results of the historical analysis, we will construct a statistical model to estimate the loan guaranty budget. The model will include all variables that were found to have significant impact on tne Revolving Fund. As part of this task a report will be prepared for DVB officials detailing our assessment of the current methodology, our recommended methodology and the exact nature of the model including data sources.

(5) Subtask 2.5: Application of the Model

After DVB approval of the model structure, we will apply the model to develop a budget estimate for five fiscal years (1988-1993). Data will be gathered and a prototype computer model will be developed for use by Booz, Allen analysts to test the model. The results of this test and five year budget projection will be briefed to DVB officials.

(6) Subtask 2.6: Refinement of the Model

Based upon the results of our prototype model, we will refine the model variables as necessary to improve its validity and accommodate any DVB requirements identified during their review. The refined model will be the basis for the development of the software program to automate its application for DVB use.

3. TASK 3: DEVELOPMENT, APPLICATION AND INSTITUTIONALIZATION OF THE LOAN GUARANTY BUDGET MODEL

The purpose of this task is to develop a computer model for use on IBM-PC microcomputers which will enable existing loan guaranty staff to accomplish all necessary budget projections and calculations validly and efficiently.

(1) Subtask 3.1: Development of LOTUS Program for Budget Model

This first subtask will involve the development of a menu-driven LOTUS software program for the budget model. The model will be automated in a manner that will permit easy modifications to input variables to accommodate the dynamic nature of the Loan Guaranty programs and legislative changes. A briefing on the model will be given to Loan Guaranty personnel who will use the model to provide user suggestions. The model will be modified, as necessary, to accommodate these suggestions.

(2) Subtask 3.2: Test and Debug Model

Booz, Allen analysts will test the model with budget data for a selected year and identify any shortcomings or inaccuracies. Based upon this test, the computer model will be modified and retested to ensure reliability and validity.

(3) Subtask 3.3: Develop Model Documentation

A comprehensive documentation package for the computer model will be developed clearly describing and explaining all calculations, the model input data requirements and underlying assumptions. This documentation will be presented in a manner that facilitates quick and easy access to any questions or issues that may arise concerning the use of this model. The documentation will also outline a procedure for updating or modifying model parameters. The package will include four copies of the model on PC-compatible diskettes.

(4) Subtask 3.4: Train VA Users

Booz, Allen will train Loan Guaranty personnel on the use of the model and its documentation. This will permit an opportunity to test the model documentation from the user's perspective. Based upon this training, we will modify the documentation, as necessary.

IV. MANAGEMENT PLAN

The management of this task has been carefully planned, and an experienced team has been assembled to assure the VA receives quality work from Booz, Allen. This section describes the management plan, and the team of individuals which will manage and carry out the tasks detailed in our approach. Our plan for the successful management of this project includes two teams of individuals: the management team which will be responsible for the management of the project; and the project team which will perform the detailed analysis and programming tasks this project requires.

Those involved in the overall direction and management of the project comprise the management team. The management team has contractual responsibility for the project, insuring that the requirements of the client are fully met. All study products are reviewed by members of the management team for clarity, thoroughness and accuracy of results. The management team is also responsible for planning and supervising detailed tasks performed by the project team on a day-to-day basis.

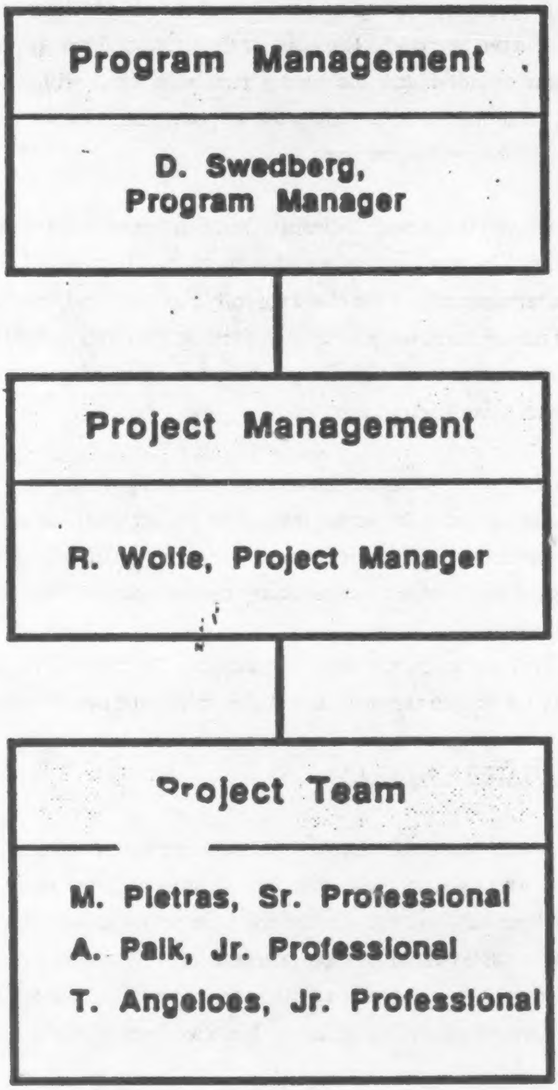
Those who w [illegible] y out the detailed analysis and programming required to complete the individual tasks comprise the project team. The project team includes individuals specially chosen for their particular skills, experience and expertise. This team has been assembled to provide the types of skills required to best carry out the tasks outlined in the previous section.

Exhibit IV-1 shows the personnel organization for this project. The following describes each of the people assigned, and his/her role in the overall management plan.

1. THE MANAGEMENT TEAM

The Program Manager for Booz, Allen's current VA contract is Daniel Swedberg, a Senior Associate with the firm. With over four years of experience in this role, Mr. Swedberg has developed a keen sensitivity to a broad spectrum of VA issues. For the VA, he has managed studies to assess the investment potential and effectiveness of automated systems. He has also managed projects to assist VA health care professionals better plan, organize and evaluate health care programs and facilities. Mr. Swedberg earned a B.S. degree in Business

Exhibit IV-1
Project Personnel Organizaton


Program Management
D. Swedberg,
Program Manager
Project Management
R. Wolfe, Project Manager
Project Team
M. Pietras, Sr. Professional
A. Paik, Jr. Professional
T. Angeloes, Jr. Professional

Finance, and an M.A. degree in Public Policy and Administration. He now has more than 11 years of consulting experience.

The Project Manager, Richard Wolfe, has recently been involved with a major project to develop economic models for implementing tax reform legislation for the Commonwealth of Puerto Rico. He has also developed a computer-based claims projection system for a U.S. Agency for International Development (AID) loan guarantee program. This project included estimating future claims, applying multivariate analysis techniques, and designing and implementing an automated model.

2. THE PROJECT TEAM

The project team will perform the detailed analysis and application design and development tasks required to support this project. The skills represented by members of the team are combined to provide the VA with study products of the highest quality.

Allen Paik has designed and developed a microcomputer-based model to estimate budget and lifecycle costs for the VA's Decentralized Hospital Computer System (DHCP) using Lotus 1-2-3. Mr. Paik's experience developing this and other financial models in support of econometrics and operations research. [illegible] makes him an important member of the project team. Another member of the team, Marianne Pietras, has worked extensively with the VA on its work measurement system. One of the primary objectives of work measurement in the VA is to provide important workload information for budgeting purposes. Working with this system, Dr. Pietras gained an indepth understanding of work processes, including budgeting processes, particularly within the Department of Veterans Benefits. The third member of the team, Tim Angeloes has recently completed an assignment for the Department of Medicine and Surgery where he assisted in an assessment of the Comprehensive Rehabilitation Centers program. He will assist in the collection of historical data on this project.

* * * * *

Resumes of all proposed staff for this assignment are included in an appendix to this proposal.

Cost Proposal No. 13614-7A

May 4, 1988

The data contained in pages 1 through 6 of this proposal have been submitted in confidence and contain trade secrets and/or privileged or confidential commercial or financial information, and such data shall be used or disclosed only for evaluation purposes; provided, that if a contract is awarded to this proposer as a result of or in connection with the submission of this proposal, the Government shall have the right to use or disclose the data herein to the extent provided in the contract. This restriction does not limit the Government's right to use or disclose data obtained without restriction from any source, including the proposer.

PRICE REVISION

(Task Order No. 7 Under
Contract V101(93)P-1097)

VALIDATION OF LOAN GUARANTY BUDGET PROCESS

for

Veterans Administration
Office of Procurement and Supply
810 Vermont Avenue, N.W.
Washington, D.C. 20420

DUNS ID #00-692-8857

BOOZ·ALLEN & HAMILTON INC.
4330 EAST WEST HIGHWAY · BETHESDA, MARYLAND 20814-4455 · TELEPHONE: (301) 951-2200 · TELEX II: 710-824-0552

TASK ORDER

Contractor: Booz Allen & Hamilton Inc Contract No. V101(93)P-1097

Client Agency: VETERANS ADMINISTRATION CENTRAL OFFICE

Project Name: VALIDATION OF LOAN GUARANTY BUDGET PROCESS Task Order No. 7

Section I - TASK REQUEST. Submit your technical and cost proposal (SF-1411) in an original and two copies to accomplish this Task Request to the VA Contracting Officer by COB APRIL 11, 1988. The original should not be bound unless in looseleaf style to facilitate the insertion of revised pages during negotiations. Specifications and requirements are attached. Your cost porposal must be on a fixed price basis using the rates as contained in the schedule of the referenced contract. This price will include all associated costs relating to this task including travel beyond the local area if required.

Submitted by: Marilyn A. Martin Date: 3/25/88
MARILYN A. MARTIN
VA Contracting Officer

**THIS TASK ORDER FORM MUST BE SIGNED IN ORIGINAL AND RETURNED WITH YOUR PROPOSAL.

Section II - TASK ORDER PROPOSAL. Attached is a technical and cost proposal (SF 1411) to accomplish this task.

SCHEDULE: Completion will be Five (5) Months days after receipt of the task order authorization.

TOTAL COST: The total amount required to complete this task order is $74,055. This price is supported by the attached price proposal (SF 1411).

Submitted by: W. R. Hockersmith, Vice President, Contracts
NAME

W R Hockersmith 5/4/88
SIGNATURE DATE

* * *

Section III - TASK ORDER AUTHORIZATION. Resources, costs, plans, and schedules outlined in your proposal dated ______________ as amended on ______________ are approved. Work to accomplish this Task Order is authorized.

1. Schedule: Start: ________ Final Completion: ________ Total Days: ________

Appropriation No. ______________________

____

Obligation No. ____________-____________

Final Price: ______________________

Approved By: ______________________ Date: __________
VA Contracting Officer

* * *

Section IV - TASK ORDER COMPLETION AND ACCEPTANCE.

1. Contractor Certification. Deliverables are completed according to specifications.

By: ______________________ Date: ________ ________
Contractor Representative

2. Client Agency Acceptance. Deliverables are complete and are acceptable as of:

By: ______________________ Date of completion: ______________
VA Project Manager

3. Project was:

Completed on: __________. On Time (____). Late (____). Days late ___

By: ______________________ Date: ______________
VA Contracting Officer

* * *

CONTRACT PRICING PROPOSAL COVER SHEET

1. SOLICITATION/CONTRACT/MODIFICATION NO.
Contract No. V101(9[illegible] P-1097

FORM APPROVED OMB NO
3090-0116

NOTE: This form is used in contract actions if submission of cost or pricing data is required. (See FAR 15.804-6(b))

2. NAME AND ADDRESS OF OFFEROR (Include ZIP Code)

Booz, Allen & Hamilton Inc.
4330 East West Highway
Bethesda, Maryland 20814

3A. NAME AND TITLE OF OFFEROR'S POINT OF CONTACT
Norma L. Barnett
Contracts Manager

3B. TELEPHONE NO.
(301) 951-2836

4. TYPE OF CONTRACT ACTION (Check)

☐ A. NEW CONTRACT
☐ B. CHANGE ORDER
☐ C. PRICE REVISION/ REDETERMINATION
☐ D. LETTER CONTRACT
☐ E. UNPRICED ORDER
☒ F. OTHER (Specify) Task Order 7

5. TYPE OF CONTRACT (Check)

☒ FFP ☐ CPFF ☐ CPIF ☐ CPAF
☐ FPI ☐ OTHER (Specify)

6. PROPOSED COST (A+B=C)

A. COST	B. PROFIT/FEE	C. TOTAL
$	$	$ 74,055

7. PLACE(S) AND PERIOD(S) OF PERFORMANCE

Place of Performance:
Bethesda, Maryland

Period of Performance:
Five (5) Months

8. List and reference the identification, quantity and total price proposed for each contract line item. A line item cost breakdown supporting this recap is required unless otherwise specified by the Contracting Officer. (Continue on reverse, and then on plain paper, if necessary. Use same headings.)

A. LINE ITEM NO.	B. IDENTIFICATION	C. QUANTITY	D. TOTAL PRICE	E. REF.
	Validation of Loan Guaranty Budget Process Task Order 7 under Contract V101(93)P-1097	1 Lot	$74,055	Ex. A

9. PROVIDE NAME, ADDRESS, AND TELEPHONE NUMBER FOR THE FOLLOWING (If available)

A. CONTRACT ADMINISTRATION OFFICE
Defense Contract Administrative Services
Management Area
300 East Joppa Road, Room 200
Towson, Maryland 21204

B. AUDIT OFFICE
Defense Contract Audit Agency/Beltway Branch
Philadelphia Region
20020 Century Boulevard, Germantown, MD 20874
James Schuchardt (301) 428-158[illegible]

10. WILL YOU REQUIRE THE USE OF ANY GOVERNMENT PROPERTY IN THE PERFORMANCE OF THIS WORK? (If "Yes," identify)
☐ YES ☒ NO

11A. DO YOU REQUIRE GOVERNMENT CONTRACT FINANCING TO PERFORM THIS PROPOSED CONTRACT? (If "Yes," complete Item 11B)
☒ YES ☐ NO

11B. TYPE OF FINANCING (✓ one)
☐ ADVANCE PAYMENTS ☒ PROGRESS PAYMENTS
☐ GUARANTEED LOANS

12. HAVE YOU BEEN AWARDED ANY CONTRACTS OR SUBCONTRACTS FOR THE SAME OR SIMILAR ITEMS WITHIN THE PAST 3 YEARS? (If "Yes," identify item(s), customer(s) and contract number(s))
☒ YES ☐ NO

Contract V101(93)P-1097

13. IS THIS PROPOSAL CONSISTENT WITH YOUR ESTABLISHED ESTIMATING AND ACCOUNTING PRACTICES AND PROCEDURES AND FAR PART 31 COST PRINCIPLES? (If "No," explain)
☒ YES ☐ NO

14. COST ACCOUNTING STANDARDS BOARD (CASB) DATA (Public Law 91-379 as amended and FAR PART 30)

A. WILL THIS CONTRACT ACTION BE SUBJECT TO CASB REGULATIONS? (If "No," explain in proposal)
☒ YES ☐ NO

B. HAVE YOU SUBMITTED A CASB DISCLOSURE STATEMENT (CASB DS-1 or 2)? (If "Yes," specify in proposal the office to which submitted and if determined to be adequate)
☒ YES ☐ NO DCASMA - Adequate

C. HAVE YOU BEEN NOTIFIED THAT YOU ARE OR MAY BE IN NONCOMPLIANCE WITH YOUR DISCLOSURE STATEMENT OR COST ACCOUNTING STANDARDS? (If "Yes," explain in proposal)
☐ YES ☒ NO

D. IS ANY ASPECT OF THIS PROPOSAL INCONSISTENT WITH YOUR DISCLOSED PRACTICES OR APPLICABLE COST ACCOUNTING STANDARDS? (If "Yes," explain in proposal)
☐ YES ☒ NO

This proposal is submitted in response to the RFP contract, modification, etc. in Item 1 and reflects our best estimates and/or actual costs as of this date.

15. NAME AND TITLE (Type)
Norma L. Barnett
Contracts Manager

16. NAME OF FIRM
Booz, Allen & Hamilton Inc.

17. SIGNATURE
Norma L Barnett

18. DATE OF SUBMISSION
May 4, 1988

NSN 7540-01-142-9845
1411-101
STANDARD FORM 1411 (10-83)
Prescribed by GSA
FAR (48 CFR) 53.215-2(c)

U.S. GOVERNMENT PRINTING OFFICE : 1984 O - 437-443

EXHIBIT A
SUMMARY OF COSTS

```
PROPOSAL NUMBER : 13614-7A        BOOZ, ALLEN & HAMILTON INC.        SUMMARY COST REPORT    (USER 5) 05/03/88
VERSION ID      : 01                                                                                PAGE    1
PROPOSED OIC    : NEWMAN
TITLE:    VETERANS ADMINISTRATION/VALIDATION OF LOAN GUARANTY BUDGET PROCESS (TASK ORDER 7 UNDER CONTRACT V101(93)P-1097)

SUBMISSION ON 05/04/88

COST CENTER (01) BASE OPNS - ASC

* DIRECT LABOR                                          NO.OF    SDL PER  TOTAL DOLLARS
                                                        HOURS     HOUR

   CATEGORY: SENIOR PROFESSIONAL             TOTALS      541     65.28       35,316
   CATEGORY: JUNIOR PROFESSIONAL             TOTALS     1153     31.93       36,815
   CATEGORY: CLERICAL SUPPORT                TOTALS       48     28.31        1,359

* DIRECT LABOR TOTALS                                   1742                 73,490        DL

* OTHER DIRECT CHARGES                                                TOTAL DOLLARS

   CATEGORY: COMPUTER CHARGES                TOTALS                             462

* OTHER DIRECT CHARGE  TOTALS                                                   462        ODC

  DL + ODC          SUBTOTALS                                                73,952

                                                                                 16        FICON      (##)

  DL + ODC + FICON SUBTOTALS                                                 73,968

                                                                                 41        G&A        (##)

  TOTAL ESTIMATED COST                                                       74,009

                                                                                 44        FEE        (##)

          PROPOSAL TOTAL (THIS CC)                                           74,055


          PROPOSAL TOTAL                                                     74,055




(##) - FICON, G&A AND FEE DOLLARS APPEARING ARE APPLICABLE TO ODCs ONLY.

     -=> USE OR DISCLOSURE OF QUOTATION DATA IS SUBJECT TO THE RESTRICTION ON THE TITLE PAGE OF THIS PROPOSAL/QUOTATION. <=-
```

EXHIBIT A-1
DETAILED COST REPORT

```
PROPOSAL NUMBER : 13614-7A        BOOZ, ALLEN & HAMILTON INC.        DETAIL COST REPORT   (USER 5)           PRINTED : 05/03/88
VERSION ID      : 01                                                                                          PAGE    1
PROPOSED OIC    : NEWMAN
TITLE:    VETERANS ADMINISTRATION/VALIDATION OF LOAN GUARANTY BUDGET PROCESS (TASK ORDER 7 UNDER CONTRACT V101(93)P-1097)

LABOR RATES EFFECTIVE AS OF 00/00/00   ANTICIPATED AWARD ON 05/01/88   SUBMISSION ON 05/04/88
               LAG TIME IS   0.0 MOS.  PERIOD OF PERFORMANCE IS   5.0 MOS.   AWI IS  3.50%  CALCULATED AWI IS  0.73%

COST CENTER (01) BASE OPNS - ASC
 FR% -   0.00%  OH% -   0.00%   FICOM -   3.50%   G&A -   8.50%   FCCM ON DL BASE - .000000   FCCM ON FICOM BASE - .000000

* DIRECT LABOR                                      BASE     NO.OF    $DL PER    TOTAL DOLLARS          FOR ALL COST CENTERS
                                                    RATE     HOURS     HOUR                              HOURS     DOLLARS
   CATEGORY: SENIOR PROFESSIONAL
             CONTRACT SPECIFIC RATE                 65.28      541     65.28       35,316.48

             AVERAGE RATES:                         65.28              65.28

             SENIOR PROFESSIONAL            TOTALS             541     65.28       35,316

   CATEGORY: JUNIOR PROFESSIONAL
             CONTRACT SPECIFIC RATE                 31.93     1153     31.93       36,815.29

             AVERAGE RATES:                         31.93              31.93

             JUNIOR PROFESSIONAL            TOTALS            1153     31.93       36,815

   CATEGORY: CLERICAL SUPPORT
             CONTRACT SPECIFIC RATE                 28.31       48     28.31        1,358.88

             AVERAGE RATES:                         28.31              28.31

             CLERICAL SUPPORT               TOTALS              48     28.31        1,359

* DIRECT LABOR TOTALS                                         1742                 73,490            1742       73,490    DL




 -=> USE OR DISCLOSURE OF QUOTATION DATA IS SUBJECT TO THE RESTRICTION ON THE TITLE PAGE OF THIS PROPOSAL/QUOTATION. <=-
```

EXHIBIT A-1
DETAILED COST REPORT

```
PROPOSAL NUMBER : 13616-7A         BOOZ, ALLEN & HAMILTON INC.         DETAIL COST REPORT   (USER 5)            PRINTED : 05/03/88
VERSION ID      : 01                                                                                                 PAGE   2
PROPOSED OIC    : NEWMAN
TITLE:    VETERANS ADMINISTRATION/VALIDATION OF LOAN GUARANTY BUDGET PROCESS (TASK ORDER 7 UNDER CONTRACT V101(93)P-1097)

LABOR RATES EFFECTIVE AS OF 00/00/00   ANTICIPATED AWARD ON 05/01/88   SUBMISSION ON 05/04/88
                 LAG TIME IS   0.0 MOS.  PERIOD OF PERFORMANCE IS   5.0 MOS.   AVI IS  3.50%  CALCULATED AVI IS  0.73%

COST CENTER (01) BASE OPNS - ASC
 FR% -   0.00%   OH% -   0.00%   FICOM -   3.50%   G&A -   0.50%   FCCM ON DL BASE - .000000   FCCM ON FICOM BASE - .000000

* OTHER DIRECT CHARGES                               TYPE   NO.OF    COST PER  TOTAL DOLLARS          FOR ALL COST CENTERS
                                                     UNIT   UNITS     UNIT                                    DOLLARS
   CATEGORY: COMPUTER CHARGES
            ~VAX-11/750:
             --CONNECT TIME                          HOURS     24       4.05            97
             --CPU TIME (2.25 HOURS
                @ $162/HOUR)                                                           365

             COMPUTER CHARGES              TOTALS                                      462

* OTHER DIRECT CHARGE  TOTALS                                                          462                     462  ODC

 DL + ODC        SUBTOTALS                                                          73,952                  73,952

                                                                                        16                      16  FICOM(##)

 DL + ODC + FICOM SUBTOTALS                                                         73,968                  73,968

                                                                                        41                      41  G&A  (##)

  TOTAL ESTIMATED COST                                                              74,009                  74,009

                                                                                        46                      46  FEE  (##)

        PROPOSAL TOTAL                                                              74,055                  74,055




(##) - FICOM, G&A AND FEE DOLLARS APPEARING ARE APPLICABLE TO ODCs ONLY.

     -=> USE OR DISCLOSURE OF QUOTATION DATA IS SUBJECT TO THE RESTRICTION ON THE TITLE PAGE OF THIS PROPOSAL/QUOTATION. <=-
```